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EFFECTS OF A FOREIGN ENTRANT ON AN INDUSTRY: CASE LIDL

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Tutkielman tavoitteet
Ulkomaalaisen kilpailun vaikutusten arviointi on noussut tärkeään rooliin rakennettaessa tulevaisuuden menestysstrategioita. Tämän tutkielman tavoitteena on selvittää Lidlin Suomen päivittäistavaramarkkinoille tulon pohjalta rakennetun skenaarioanalyysin avulla, miten ulkomaalainen markkinoille meno vaikuttaa toimialaan. Tarkastelen markkinoille menoa osana toimialan kehitysprosessia ja vertaan sen vaikutuksia markkinatrendeihin. Tarkastelen sekä suoria että epäsuoria vaikutuksia kilpailijoiden oletettuihin reaktioihin perustuen.

Tutkimusasetelma ja -menetelmät
Teoriaosa kuvaa kilpailun dynaamisena prosessina, joka ajaa toimialan kehitystä. Pääasiallisina lähteinä käytän strategista ja kansainvälisen liiketoiminnan kirjallisuutta, jota täydennän vähittäiskaupan teorioilla ja raporteilla. Tämä on laadullinen tutkimus, joka hahmottaa skenaarioita siitä, kuinka Lidlin markkinoille tulo tulee vaikuttamaan Suomen päivittäistavarakaupan toimialaan. Lähestyn ongelmaa analysoimalla toimialaa, Lidlia, nykyisiä kaupan ryhmiä ja markkinatrendejä sekä vertailemalla havaintoja Lidlin markkinapenetraation vaikutuksista muilta Euroopan markkinoilta. Empiirisen osan lähteinä toimivat markkinalähteet, tiedotusvälineet ja asiantuntija haastattelut.

Tulokset
Lidlin markkinoille tulo vahvistaa toimialan trendejä ja homogenisoi Suomen ja Länsi-Euroopan markkinoita kilpailijoiden reaktioiden toimiessa pääasiallisina kehitysajureina. Toimialan kansainvälistyminen lisääntyy nykyisten toimijoiden kehittäessä kansainvälistä yhteistoimintaa parantaakseen kilpailukykyään. Tavarantoimittajien neuvotteluvoima heikkenee ja kuluttajat hyötyvät alemman hintatason ja lisääntyneiden valikoimien muodossa. Lidl tulee saavuttamaan vakaan aseman Suomen markkinoilla kustannusetunsa ansiosta. Kiristyvän kilpailun johdosta kilpailijoiden on lisättävä houkuttelevuuttaan kehittämällä myymälöitään ja tuotteitaan sekä alentamalla kustannuksiaan. Lidlin menestykseen vaikuttavat pääosin asiakkaiden ostokäyttäytyminen ja kilpailijoiden reaktiot.

Tämä tutkielma tukee useimpia vähittäiskaupan teorioita ja syventää ymmärtämystä siitä, kuinka kilpailijat reagoivat markkinoille menoon ja mitkä siten ovat markkinapenetraation epäsuorat vaikutukset toimialan kehitykseen. Erot toimialojen kehityksissä kansallisella tasolla tarjoavat liiketoimintamahdollisuuksia. Ulkomaalaiset ketjut, jotka hyödyntävät näitä markkinarakoja, edistävät toimialojen konvergenssia, kiristävät kilpailua sekä parantavat paikallisten yritysten tehokkuutta johtaen positiivisiin hyvinvointivaikutuksiin kuluttajille.

Avainsanat
Markkinoille meno, kilpailu, toimialan kehitys, kilpailuetu, puolustusstrategia, päivittäistavara, vähittäiskauppa.

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ABSTRACT

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EFFECTS OF A FOREIGN ENTRANT ON AN INDUSTRY: CASE LIDL

Objectives

Assessing the impacts of foreign competition has an increasingly important role in the process of building strategies for future success. The objective of this study is to find out how a foreign entrant affects an industry deducing from a scenario analysis concerning market entry of Lidl into the Finnish daily consumer goods industry. I will examine the market entry as a part of the industry evolution process, seeing how the impacts reflect to the market trends. I will assess both direct and indirect effects based on the hypothesized competitor reactions.

Methodology

The theory part depicts competition as a dynamic process that facilitates industry evolution. The main inputs are strategy and international business literature complemented with retail theory and reports. This is a qualitative research outlining scenarios how Lidl's entry will affect the industry. I will approach the research problem by analyzing the industry as well as Lidl and the incumbents, examining market trends, and benchmarking observations of Lidl's entry into other European markets. Sources for the empirical part are market data, media, and expert interviews.

Results

Lidl's entry will reinforce the industry trends and homogenize Finnish and west European markets with competitor reactions as the main development driver. Cross-border consolidation will increase as the incumbents seek alliances to improve their competitiveness. The power position of suppliers will deteriorate while consumers will reap the benefits in terms of lower price level and increased variety. Lidl will leverage its cost advantage to gain a solid position in the Finnish market. Due to intensifying competition, the incumbents will need to improve their value proposition by developing their store formats and product offering as well as streamlining their cost structure. The main factors determining the extent of its success are customer behavior and competitor reactions.

This study seems to support most retail evolution theories and provide further insights on how the competitors react to a market entry and thus the indirect impacts an entry has on industry evolution. Differences in national industry development will provide market opportunities. Foreign companies exploiting these opportunities will facilitate the market convergence as well as intensify the competition and increase the efficiency of local companies, providing positive welfare implications for the consumers.

Key words

Market entry, competition, industry evolution, competitive advantage, defensive strategy, daily consumer goods, retail.

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1. INTRODUCTION

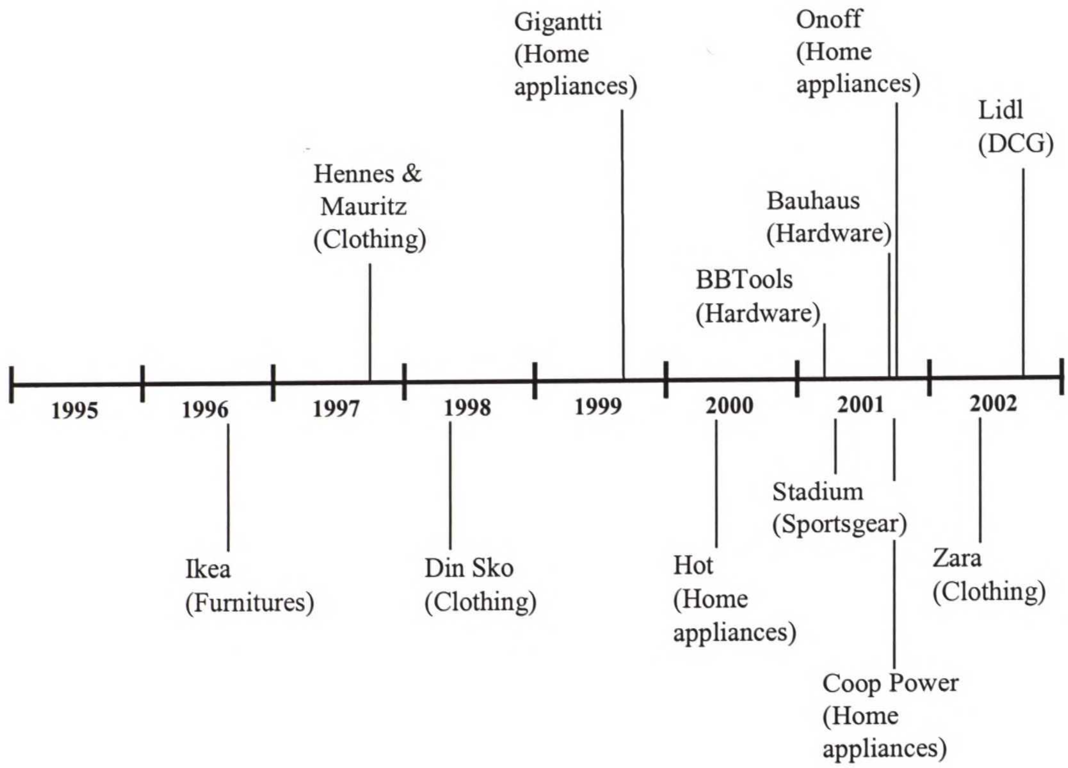
Exposure to international competition has become a reality in most industries. Assessing beforehand, how a foreign entrant will affect an industry is essential for both the entrant and the incumbents. Expected competitor retaliation is one of the entry barriers (Söllner & Rese 2001: 27) that needs to be assessed in order to decide upon the attractiveness of the entry as well as the optimal market entry strategy. The incumbents have to make judgments on the impacts on the competitive environment as they proactively build their competitive advantage (Krokfors 1993) and strategies for future success. Olin emphasizes the role of competitor intelligence in mature markets as well as going beyond observations to prediction of competitor reactions (Olin 1992: 9-10).

The topic of how a foreign entrant affects industry evolution has so far been limitedly researched. It appears that retail evolution theories, such as wheel of retailing and retail life-cycle, provide an understanding of the motives for foreign entries. However, they fail to explain adequately the causal relations between a market entry and the indirect impacts caused by incumbent defensive reactions, which can actually be the main drivers of industry evolution. I will discuss, how a market entry of a foreign retail chain affects industry structure and dynamics. This study provides views on how Lidl will operate in Finland, how the incumbents can better position themselves in the intensifying competition, how the competitors are likely to react, and how these factors combined will affect the Finnish daily consumer goods industry.

1.1. Background

In retail sector, competition is becoming increasingly international as large, international chains extend their operations into various countries. Numerous foreign chains have established their presence in Finland during the past years (figure 1). For many companies the Finnish market entry has been a part of their broader internationalization strategy. The entrants have often been welcomed by the consumers as they commonly increase the variety of choice and offer lower prices. The foreign entrants have managed to rapidly establish a solid market position in a number of industries, such as Ikea in furnitures and Hennes & Mauritz in clothing.

Figure 1. Examples of foreign market entries in Finnish retail sector, 1995-2002



The incumbents cannot ignore the threat of foreign entrants and need to prepare for intensifying competition. The daily consumer goods sector has thus far been dominated by domestic groups. Swedish Axfood entered the market in 1999 through an acquisition, but has not significantly affected the industry evolution due to its similar operations with incumbents and entering market via acquisition. German discounter chain Lidl will enter the Finnish market in the fall of 2002. The market entry is likely to cause many changes in the industry, as Lidl introduces a new business model in the market, increases industry capacity, and has a significant relative cost advantage. Examining these changes and their sources enables to hypothesize how foreign entries in general affect industries.

1.2. Research problem

The research problem is to find out how Lidl's market entry affects the Finnish daily consumer goods industry and how the effects can be generalized to other potential foreign entries. I will examine these changes as part of the industry evolution and see how they reflect to industry trends. Assessing the effects of Lidl's entry can be broken down into sub-questions as depicted in figure 2. The question will be discussed both on industry and company level. The industry level implications can be divided to examining how the market entry will affect internationalization of the industry and the industry value chain dynamics. I will analyze the motives for consolidation and factors that will drive companies to cross-border operations. I will discuss how the power position of suppliers will change, what happens to the level of competition and how it will affect industry profitability, and what role the consumers play.

Figure 2. Research problem and sub-questions

How will Lidl's market entry affect Finnish daily consumer goods industry?		
What are the direct impacts?	**What are the indirect impacts?**	**How will these impacts reflect to industry trends?**

Cross-border consolidation	Value chain dynamics	Development of store formats	Development of product offering	Cost structures
•How can Lidl leverage its international operations to create a cost advantage? •How can incumbents achieve economies of scale through cross-border operations and alliances? •Will the entry entice further market entries?	•How will Lidl be positioned? •How will the entry affect different groups and chains? •What will happen to the price level, profitability, and intensity of competition? •What will happen to the power position of suppliers? •Will the consumers adopt Lidl's concept?	•What are the prevailing store format development trends? •What are Lidl's store formats like? •How can store format development be used as a defensive strategy?	•How can product offering be used in differentiating from Lidl? •How will the entry affect private label development in Finland? •How will consumer trends affect relative position of incumbents?	•What are the revenue structures of Lidl and incumbents like? •What factors explain differences in cost structures? •How can incumbents improve their cost position?

Company level implications focus on business model and operations development, assessing how Lidl's market entry will affect the incumbents' differentiation strategy and cost position. I will discuss, how companies can differentiate themselves in terms of store formats and product offerings and compare Lidl's revenue structure with the competitors, evaluating what causes the differences and how the competitors can improve their position.

In order to accomplish this, I will analyze the industry trends and Finnish market characteristics as well as make hypotheses about how Lidl will operate in Finland and how the competitors will react to the market entry. In order to evaluate the strength of the impact, I will assess Lidl's relative competitive advantage and the incumbents' opportunities to respond to the competitive threat.

1.3. Research objective

With this report, I aim to outline scenarios how Lidl's market entry will probably affect the evolution of Finnish daily consumer goods industry. By understanding the market entry's effects we can better predict what the success factors of the future are in retailing, on which proactive competitive strategies should be based. Hopefully this study will provide the stakeholders (competitors, Lidl, media, and academic society) fresh insights and a more comprehensive picture of the topic. *This study takes primarily the viewpoint of management of incumbent retailers*, examining how the industry changes will affect the business models in Finnish DCG industry. Competitor analysis of Lidl is generally characterized by difficulties in obtaining data due to the company's zero disclosure policy. A further objective is to merge fragmented pieces of information into an analysis of Lidl's operations relevant to the Finnish market entry. A secondary viewpoint in this study is to assess from Lidl's perspective, how the chain's concept will succeed in the Finnish market and how the competitors are likely to react to the entry.

In a broader picture, my objective is to evaluate how a foreign entrant affects an industry, an increasingly important topic that has thus far received little academic interest. I will try to find out what role foreign entrants play in an industry evolution, what the main levers for change are, and what factors explain the strength of the impact. Understanding the generic implications helps to prepare for industry changes in other industries as more and more industries are becoming exposed to international competition.

1.4. Findings

Lidl's entry will reinforce the industry trends and homogenize Finnish and west European markets. Even though Lidl will not threaten the position of major Finnish retailers, it will force the companies to make changes in their operations in order to fight for declining market shares. The market entry will motivate cross-border industry consolidation in two dimensions:

international alliances will be leveraged in order to gain scale economies and international partners are potentially sought to improve ones' competitiveness or to engage in hard discounting. The intensifying competition will decrease industry price level and profit margins, reduce the power position of suppliers, and offer customers more choices as well as affect their purchasing patterns to some extent. Competitive pressure might even facilitate structural changes. The competitors will need to further differentiate themselves with respect to store formats and products as well as streamline their operating costs by lowering the purchasing prices and enhancing logistics. The effects of the market entry combined with the main development drivers are depicted in figure 10, illustrating the research structure.

1.5. Lidl's market entry

In order to better understand the effects of Lidl's market entry, I will shortly describe the company's background and activities in Finland.

1.5.1. Brief description of Lidl

Lidl & Schwarz Stiftung & Co (hereafter Lidl & Schwarz) operates in wholesale, retail, and meat processing sectors as well as sells logistic services. The company was founded in 1930, and has its headquarters in Neckarsulm, near Stuttgart, Germany. Retail and wholesale account for majority of the group's revenues. A subsidiary of the group, Lidl Stiftung & Co KG (hereafter Lidl) operates a retail chain Lidl, which is one of the leading retailers in Europe. Lidl is a hard discounter, with its business philosophy based on simplicity. Lidl offers its customers a narrow, low priced and mostly private label product range in its no-thrills outlets. In addition to Lidl, the group operates Kaufland hypermarkets, Kauf-Markt shopping malls, as well as Handelshof and Concorde stores. (Tuormaa 2001: 13).

1.5.2. Key figures

Lidl & Schwartz is owned by Dieter Schwarz (Amadeus 2002a). Private ownership has enabled the company to maintain its policy of minimal public reporting, which has created a mysterious image surrounding the company. Lidl & Schwarz has not published its sales figures, but the 2000 retail sales are estimated to be 12,000 - 16,500 million Euro (PricewaterhouseCoopers 2001: 5; Deloitte Touche Tohmatsu: 10). Lidl operates in 12 European countries and is the fifth largest retailer in the area (Hoovers 2002). Lidl is ranked as the 36th largest retailer in the world by revenue, where as Kesko is the 82^{nd} largest for comparison (PricewaterhouseCoopers ref. Retailindustry.com 2002). The company has very low margins, the 2000 operating margin was estimated to be 2% in UK and 3-4% in Ireland (Reuters 15.9.2001, 4.10.2000). The company has ca. 40,000 employees (Forbes ref. Supermarket Strategic Alert 2001: 8).

1.5.3. Lidl's business model in Finland

Lidl is entering the Finnish market in the fall of 2002. The chain is estimated to open ca. 40 stores in the fall around Finland (Sinervä 2002c; Interviews) and a total of ca. 100 stores[1] within the next 3 years (Interviews). Unlike most foreign retail chains that have focused on the Helsinki area, Lidl is targeting the whole country. The estimates about the store formats Lidl is using in Finland have been contradictory (Reuters 27.4.2001; Vihma 2001: 25), and the interviewees were not able to provide any more solid evaluations. Media sources estimate Lidl to offer prices on average 15-20% lower than the established competitors (A-Plus 2002; Uusitalo & Rökman 2002), while the interviewees were fairly unanimous about the price image difference being ca. 10%. Media find that Lidl can easily capture a 5-6% market share within the next three years (Reuters 26.3.2001), where as the interviewees considered the figure to be 3-5%.

Lidl Suomi ky is headquartered in Espoo with regional offices in Tampere, Kuopio, and Oulu (Jänkä 2001: 9). The company has built a 30,000m^2 distribution center in Janakkala, near Hämeenlinna. The required investments for the construction and machinery of Janakkala distribution center are estimated at ca. 35 million Euro and ca. 1.7 million Euro for construction of each store (Jänkä 2001: 9). The size of the greenfield investments demonstrates Lidl's commitment to the market. Lidl will provide its own logistic services in Finland (Leutola 2001: 6). It will procure some of its products from Finland, and has started negotiations with a number of local suppliers (Sinervä 2002c).

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[1] Media sources suggest a higher figure, 150-200 stores within the next 2-3 years (Reuters 26.3.2001; A-Plus 2002). The figure could be somewhere between those estimates, but closer to 100 outlets seems more realistic considering demand side factors and availability of outlet locations.

1.6. Daily consumer goods industry

Daily consumer goods (DCG) industry is defined here in two dimensions: by products and by industry value chain activities. Many sources use the term "fast moving consumer goods" instead to refer to the industry.

1.6.1. Products

Finnish Food Marketing Association (2001) defines daily consumer goods as groceries and such products that people are used to buying in pursuance of their grocery purchases. The basic categories of daily consumer goods are food and non-food. A.C Nielsen (ref. Finnish Food Marketing Association 2001), a global market research company collecting statistics for daily consumer goods industry, uses following categorization of DCG products: food, beverages, tobacco products, techno chemical products, household paper products, magazines and non-selective cosmetics.[2] Groceries (consisting of food and beverages) account for on average 80% of the volume of total sales of daily consumer good outlets in Finland (Finnish Food Marketing Association 2001).

EU uses a broader definition. In addition to the above mentioned, EU includes sales of, e.g., restaurants and cafes, sales of alcohol beverages, and HoReCa[3]-wholesales. This study defines DCG in the narrower scope depicted in the previous paragraph. By this definition, the total sales of the Finnish daily consumer goods industry in 2000 were 9.9 billion Euro. (Finnish Food Marketing Association 2001).

1.6.2. Industry value chain

DCG industry consists of production (upstream activities) and distribution (downstream activities) of daily consumer goods. The commonly used categorization for main value chain roles is suppliers, wholesalers, and retailers (figure 3). This research focuses on the downstream activities: retailers and wholesalers and their interlinkages with suppliers.

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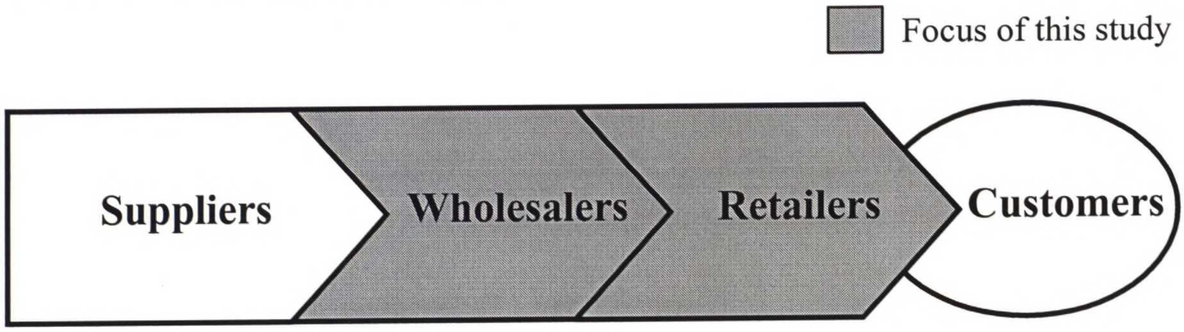
[2] Some larger outlets sell products such as clothes and sporting goods, which are not included in the above classification. Sales of such products provided that they are sold via outlets focusing on daily consumer goods sales may be included in the figures as it is impossible to exclude these sales from companies' data.

[3] HoReCa is a commonly used abbreviation for hotels, restaurants, and catering. It also includes the DCG wholesales to public organizations.

Figure 3. Daily consumer goods industry value chain



For sake of simplicity, I will include in the industry definition only those upstream companies that process, refine, and produce (hereafter term process is used to describe all these activities) raw materials into daily consumer goods and primary producers who sell their products directly to wholesale and retail companies. The primary and intermediate product producers who supply processing companies with raw materials and semi-finished products are excluded as their link to wholesale and retail sector is only indirect. Processing companies and primary producers who sell their products directly to wholesale or retail companies (and thus are included in the industry definition used here) are called suppliers. Suppliers process the raw materials and intermediate products into consumer goods and sell them to wholesalers.

The distribution process involves wholesale and retail of goods (see appendices 1 and 2 for description of wholesale and retail companies operating in Finland). Wholesalers and retailers provide the link between production and consumption as well as improve efficiency of the exchange processes, adjust the discrepancy of assortment, provide routinization of transactions, and facilitate the search process (Alderson ref. Esbjerg & Skytte: 9). Wholesale is an intermediary function taking place in business-to-business market. Wholesalers procure large quantities of goods and resell them in smaller lots to retail companies[4], taking care of the shipping and inventory storage functions. Cooperation between wholesaler and retailer can cover multiple areas, such as marketing and research. In Finland, all major retailers have integrated backwards into wholesaling. Retailers operate in the downstream of the value chain, selling the individual goods to end users in retail outlets or through other channels, such as electronic

[4] I will not make a difference between wholesale companies selling to multiple retailers and HoReCa customers and companies such as Inex Partners, which only handle the procurement and logistics for predefined companies, but refer to them both as wholesalers.

storefronts[5]. DCG retail trade is divided in Standard Industry Classification (SIC) into department store trade, non-specialized retail trade of daily products, specialized retail trade of daily products, and retail trade of alcoholic beverages (Santasalo & Kontio 1995: 168). This study focuses on the second category.

1.7. Definitions

Here I have defined some of the central terms that will be used through out the report.

Chain: "A chain retailer operates multiple outlets (store units) under common ownership; it usually engages in some level of centralized (or coordinated) purchasing and decision making. " (Berman & Evans 1995: 107). LTT (1994: 6) emphasizes that chains are voluntary consortiums of independent retailers. In Finnish DCG industry, there are wholesale led chains, such as K-ryhmä, and retail led chains, such as S-ryhmä. The wholesale led chains are organized by one or more wholesalers, and base their operations on cooperation between the wholesaler and retail companies. The retail led chains operate under a cooperative organization jointly founded and owned by the member companies. (LTT 1994: 7).

Store format: Goldman (2001: 223) defines retail format to consist of offering and know-how parts of the format. Offering includes external elements (e.g. assortment, shopping-environment, service, location, and price). Know-how consists of internal elements retail technology and retail culture, thus determining the retailer's operational strength and strategic direction.. I use the term store format or retail format to refer to the external elements and examine the internal components in other contexts. Store format reflects the business model of the retailer, with size as the main attribute (see appendix 3 for store format classifications).

Discounter: Discounters provide "limited, heavily discounted, largely own label food products through no-frills, cost-focused, warehouse-style small supermarket stores". Discounters sell at high volumes and accept lower prices (Kotler & Armstrong 2001: 476). There are hard and soft discounters distinguished by product range and store layouts. Hard discounters have focused product ranges with ca. 700 stock keeping units focusing essentially on grocery items and are

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[5] The effects of new business models, such as online retailing and vending machines, are not discussed further in this analysis, as their effects on the Finnish market are currently marginal and growth is likely to occur in the long term, e.g., committee of electronic trade estimates the market share of online retailing to be 5-10% in 2010 (Seeling 2000: 10).

made up chiefly or mainly of private labels. The stores stock only one type of each product, either branded or private label. Hard discounters have smaller store formats and limited shopping comfortability. The product ranges of soft discounters comprise of ca. 1200 stock keeping units, including fresh-product assortment and some branded products. The store formats are larger with a degree of shopping comfort. (Standard & Poors 2001: 9). However, market sources commonly use the term soft discounter in a broader context. Another categorization of discounters is: limited line discounters, extended range discounters, and discount superstores (Berry & Holmes ref. McGoldrick & Davies 1995: 192). I will use Standard & Poors' categorization, as it is more commonly used in the market sources.

Corner store: Small supermarkets and self-service stores are commonly referred to as "corner stores" in this report, when they are located in the vicinity of customers. The Finnish term "lähikauppa" describes explicitly the vicinity of store location.

Convenience store: Convenience store is "a small store, located near a residential area, that is open long hours seven days a week and carries a limited line of high-turnover convenience goods." (Kotler & Armstrong 2001: 475). In American articles "convenience store" is often used to describe a gas station that sells a variety of DCG products. I use the term "petrol forecourt" to describe such retailers following Reuters Business Insight's practice (e.g., Ehrnreich 1998: 12).

Private label: Private label (PL) products are "products manufactured, distributed and marketed exclusively for and by specific retailers. They are distinct from manufacturers' branded products, which are distributed by more than one retailer, and unbranded products (such as loose fresh vegetables)." (Ehrnreich & Ackrill 1998: 170). I will classify the private label products into three categories. *Standard* PLs are products that sell at prices somewhat lower to branded products. Pirkka is an example of standard PLs. *Hard discount* PLs, such as Euroshopper, sell at considerably lower prices compared to branded products. *Premium* PLs sell at slightly lower or even higher prices than branded goods, and are positioned as high end products. Some of Stockmann's PL products can be classified into this category.

2. COMPETITION AND INDUSTRY EVOLUTION IN DAILY CONSUMER GOODS RETAILING

This study examines how competition intertwines with industry evolution. Competitive pressure facilitates company level reactions, which leads to industry evolution, and changes in the industry landscape in turn influence the competitive environment. In this report, I will examine the industry dynamics with regards to established competitors, suppliers, consumers, and foreign entrants. I will include the dynamic aspects of competition by examining industry evolution, how a foreign entrant can affect the industry evolution, and what determines the strength of the impact. I will discuss the theory from the point of view of DCG retail industry whenever possible.

2.1. Established competitors

"Industry structural analysis can be used at greater depth than industry as a whole." (Porter 1980: 126). Strategic group is an analytical tool for structural analysis, forming an intermediate frame of reference between individual companies and industry as a whole. Strategic groups analysis can be used for revealing differences in strategies among competitors that account for persistent performance differences (Olusoga et al..: 153; Oster 1994: 93). It can help to understand the positioning of companies in relation to one another as well as industry structure and evolution (Grant 1998: 94). Söllner and Rese (2001: 25) interpret the strategic group concept as a competitive counterpart to customer segments. I will use strategic groups as a tool for examining competition between retailers. I will also discuss how competitor responses can be analyzed in order to consider for the dynamic nature of competition.

2.1.1. Strategic groups

Porter defines strategic group as a set of firms or business units, which pursue the same or similar strategy with respect to central strategic dimensions, such as specialization, channel selection, vertical integration, cost position, and service. (Porter 1980: 127-129). Hatten and Hatten (ref. Smith et al. 1997: 149) find that strategic groups segment firms "into sets of companies whose competitors, actions and results are relevant to each other". They (ref. Olusoga et al. 1995: 153) also link use of similar resources with the strategic grouping. Oster (1994: 80) supports the resource-based view as companies within same strategic group possess common specific assets and thus follow common strategies within the group in setting key decision variables.

Researches of Cool and Schendel as well as Fiegenbaum and Thomas (ref. Olusoga et al. 1995: 155) conclude "that strategic group formation should primarily be based on the specific investment strategies of firms, especially their scope and resource commitments. Scope variables consist of: (1) the range of market segments targeted, (2) the types of products and/ or services offered in the market segments selected, and (3) the geographic reach of product-market segments." Strategic groups are not static, and "changes in the structure of the industry can either facilitate the formation of new strategic groups or work to homogenize groups[6]." (Porter 1980: 136)

2.1.1.1. Degree of rivalry

Degree of rivalry within a strategic group is dependent on the structure of the group, e.g., the size of the group and the companies' differences in scale and risk preferences (Porter 1979 ref. Dranove et al. 1998: 1031). In this study, I will propose that *Lidl's market entry will form a new strategic group into Finnish DCG market.* In order to find out how this will affect the degree of rivalry, it is essential to examine the rivalry between strategic groups.

Presence of several strategic groups will generally increase the industry rivalry because it implies greater diversity or asymmetry among firms (Porter 1980: 138). Porter (1980: 138-140) suggests that four factors affect how strongly the strategic groups in an industry will interact in competing for customers:

1) Market interdependence of the groups, i.e., the extent to which the customer targets overlap. Market interdependence is the most important factor influencing the degree of rivalry between groups. Differences in strategies in a case of high market interdepency lead to the most vigorous rivalry. A particular strategic group will be most exposed to rivalry from other strategic groups that share market interdependency.

2) Product differentiation achieved by the groups. High degree of product differentiation tends to moderate the competition.

3) The number of strategic groups and their sizes. The more and more equal in size the strategic groups are, the higher the rivalry in general.

4) Strategic distance among groups, i.e., the extent to which strategies diverge in terms of key variables. Strategic difference has a positive correlation with the degree of competition.

The four factors interrelate to determine the pattern of intergroup rivalry for customers (Porter 1980: 140). Smith et al. (1997: 150) suggest that the *level of rivalry will be greater between groups than within groups.*

2.1.1.2. Entry and mobility barriers

Oster proposes that barriers to entry may be specific to strategic groups, thus partially explaining the differences in strategic group profitability. This implies that also entry barriers should be assessed on the strategic group level. Strategic group specific entry barriers thus provide barriers to shifting strategic positions between groups. These barriers are called mobility barriers, consisting of structural barriers and competitor retaliation (Söllner & Rese 2001: 27). Competitor retaliation is thus relevant both when examining entry barriers for new entrants and mobility barriers for incumbents seeking to reposition themselves. Risk-adjusted profit differences between strategic groups persist only if there are mobility barriers (Porter 1980: 132-135; Oster 1994: 94). Strategic groups with high mobility barriers are relatively more insulated from rivalry by their place in the configuration of strategic groups (Porter 1979: 215). McGee and Thomas (ref. Dranove et al. 1998: 1031) emphasize the importance and constancy of mobility barriers, and suggest that mobility barriers form a much former basis for identifying groups than company strategies.

2.1.1.3. Criticism towards strategic group theory

Strategic group research has been criticized and it has been questioned whether groups exist and whether there is a dependence of firm's performance on strategic group membership. Further criticism includes using standard methods employing some form of cluster or factor analysis, lacking objective analogue in the natural environment, and questioning if strategic group analysis provides information that cannot be obtained through industry or company analysis. (Reger &

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[6] Changes in the strategic groups will be discussed with defensive strategies, see section 2.6.2.

Huff 1993: 103; Dranove et al.. 1998: 1029). In this study, I will use strategic groups inductively, as an analytical tool for grouping companies or chains with regards to relevant strategic dimensions in order to analyze competitive environment and positioning of chains and to some extent, mobility barriers. Dranove et al. (1998: 1041) point out, that grouping firms may sacrifice information and introduce noise into analysis when studying firm-level effects. This study focuses on examining industry level or aggregated company level effects thus moderating the shortcomings of this approach.

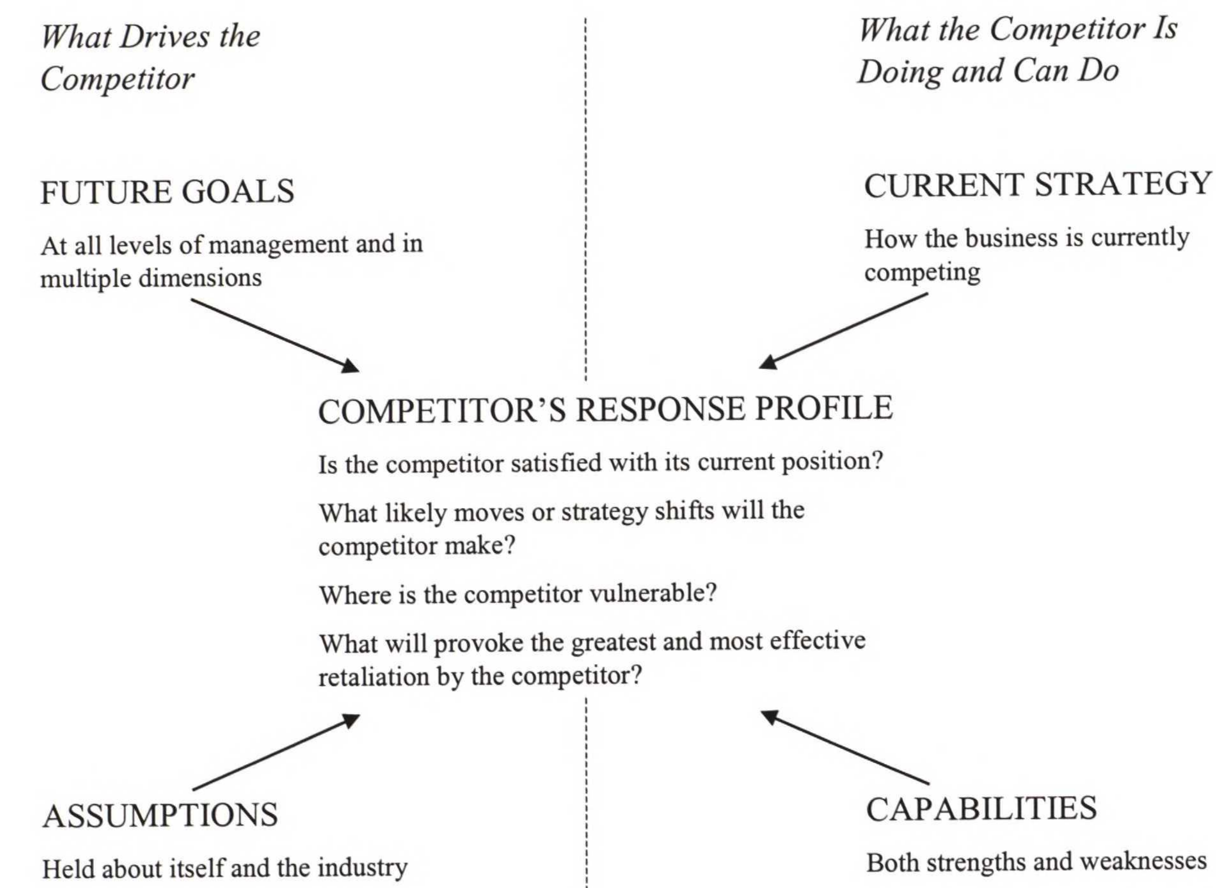
2.1.2. Competitor responses

"The direct effect of entry by one challenger in intensifying competition in the market will be offset to some extent by the effect of reductions in the incumbent's output on its ability to produce at low cost." The offsetting effect may even outweigh the former, when incumbents and their potential rivals are highly asymmetric (Seabright 1996: 542). The indirect consequences can thus have a far more important effect on the intensity of industry competition in case of a market entry. When discussing entry barriers, Söllner and Rese (2001: 30) emphasize, that even though structural barriers could be surmounted, the incumbents demonstrate great willingness to retaliate. Porter (1980: 47, 71) identifies competitor analysis as a necessary component of strategy formulation. He sees analyzing each significant or potential competitor as an important input for forecasting future industry conditions.

2.1.2.1. Competitor's response profile

The indirect consequences can be examined through analyzing competitors' potential reactions. Porter proposes a framework for competitor analysis, where competitor's (existing or potential) response profile is a function of four components: future goals, current strategy, assumptions, and capabilities (figure 4). Analyzing *future goals* allows predicting, whether a competitor is satisfied with its current position and how likely it is to change its strategy. Knowing the goals will also help to predict the competitor's reactions to strategic changes. The companies make *assumptions* about itself, the industry, and other companies in it. Each company operates based on these assumptions, whether they are accurate or not. Understanding the assumptions might reveal the competitor's blind spots that can be exploited as a strategic lever. *Current strategy* reflects how the competitor is currently competing, what its key operating policies are in each functional area and how it seeks to interrelate the functions. The competitor's *strengths and weaknesses* "determine its ability to initiate or react to strategic moves and to deal with environmental or industry events that occur." The four components are combined to form a profile how the competitor will likely respond. (Porter 1980: 47-67, 71)

Figure 4. Competitor's response profile



Source: Porter (1980: 49)

A further step in building a response profile, is determining the competitor's defensive capabilities. The purpose is to identify, how competitors will be affected by environmental or competitive changes. One can analyze how *vulnerable* the competitor is to predicted changes, which changes will likely *provoke* retaliatory measures, and which moves the competitor cannot *effectively retaliate to.* (Porter 1980: 68).

In this report, I will implicitly use the competitor response model aggregated for all incumbents to find out the industry level implications without building a response profile for each competitor.

I will disaggregate the framework when discussing the position of incumbents with regards to individual elements, such as store formats. Industry level approach seems to moderate to some extent the difficulties perceived by Porter (1980: 48) concerning finding data for competitor analysis. However, in a concentrated industry, the leading incumbents can be assumed to have enough market power to influence the industry development, favoring an approach to examine individual companies' response profiles. Reasons for choosing an industry level approach are further discussed in section 3.1.1.

2.1.2.2. Defensive strategies

Each company is vulnerable to attacks of new entrants and established competitors, mutually to be called "challengers". Companies can deploy defensive strategies aiming to lower the probability of attack, divert attacks to less threatening avenues, and lessen their intensity. Porter (1979: 482-487, 504-512) notes that almost all effective defensive strategies require investment and reduce short-term profitability. The defensive strategies should be deployed both before and after the challenger's moves. Entrant's lower commitment and increasing exit barriers induce for early reactions against a market entry. Lidl has made a firm commitment on entering the Finnish market, so responsive strategies instead of strategies aiming at deterring the entry will play the key role. One of the goals of this report is to *provide information on the anticipated changes in the DCG industry*. Another goal is to assess *how well and by what means the incumbents can respond to the changes*.

2.1.2.2.1. Defensive tactics

In order to implement the defensive strategy, competitors invest in defensive tactics. Three key defensive tactics are raising structural barriers, increasing expected retaliation, and lowering the inducement for attack. *Raising structural barriers* includes filling product or positioning gaps, blocking channel access, raising buyer switching costs, and defensively increasing scale economies. *Increasing expected retaliation* consists of, e.g., signaling commitment to defend, accumulating retaliatory resources, and establishing defensive coalitions. Defenders can *lower the inducement for attack* by reducing profit targets and managing competitor assumptions. The tactics aim at reducing the challenger's profits and eroding its relative position. (Porter 1979: 487-500)

A firm must decide which tactics will be the most effective in its industry considering the potential challengers it faces. Porter (1979: 500-503) proposes tests such as measuring the strategy's value to buyers and aiming to maximize the challenger's cost disadvantage for identifying the most effective strategies. I will result in *identifying defensive strategies used in benchmark markets and using expert opinions to evaluate the effectiveness of defensive strategies*.

2.1.2.2.2. Competitor analysis

A company needs to understand the nature of the threat before it can deter or respond to a challenge. Competitor analysis can be used for strategic planning of own activities and especially predicting the behavior of the company's rivals. (Routamo & Routamo 1988: 44). The companies also need to consider the counter reactions that the competitors are likely to engage in. This includes identifying the potential counter strategies, assessing which companies are likely to deploy them, and planning what the company's own actions would be after such reactions. (Routamo & Routamo 1988: 56-57). The importance of competitor analysis depends on the industry structure, consolidation, and competitive strategies (Grant 1998).

The essence of competitor analysis is acquiring information about competitors (competitor intelligence) and predicting their behavior, e.g., by the means of game theory. Competitor intelligence involves systematic collection and analysis of publicly available information about the rivals. Predicting competitor's behavior requires identification of competitor's current strategy, objectives, assumptions about the industry, and their capabilities based on the information obtained[7]. These elements are used for constructing a picture of how the competitor will shift its strategy and how it will likely respond to the strategy shifts of one's own company. Companies can thus attempt to influence the behavior of their competitors towards a favorable direction. (Grant 1998: 94-101). Routamo and Routamo (1988: 11) highlight the importance of competitor analysis for Finnish companies, as the companies need to develop their competitiveness to move from passive, defensive strategies to active, offensive strategies due to the liberalization of trade.

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[7] Analogical to elements in competitor's response profile (see section 2.1.2.1).

Competitor analysis serves two purposes in this research. First, to make hypotheses concerning Lidl's business model and operations in Finland. Second, to build hypotheses about likely reactions of the Finnish incumbents and potential further entrants as discussed in the previous chapter. I will use tools for competitor intelligence and *combine market information with expert opinions to predict the behavior of Lidl and its competitors in order to find out the implications for the Finnish industry*.

2.2. Suppliers

Porter (1980: 27-28) suggests relative industry concentration, substitutability and level of differentiation of products, relative importance of the supplier buyer relationship, switching costs, and threat of forward integration as factors influencing the bargaining power of suppliers. In the European food industries, major retailers have been growing their power since the early 1980s. This is attributable to increasing consolidation and cross-border retailing, enhanced information on sales performance and product profitability, and growing customer appreciation through private label and customer loyalty schemes. (Ehrnreich 1998: 9). Increasing consolidation makes the suppliers reliant on a small number of retailers, forcing the suppliers to respond to the demands of the retailers. The retailers begin to influence marketing and other strategies put in place by the manufacturers. (Gurdijan et al. 2000: 74; Ehrnreich 1998: 133) Dependency on fewer retailers also affects the risk level of suppliers (SCA 2001: 6). "Increased capacity in a stagnant market will begin to shift the balance of power away from manufacturers and towards large retailers" (Ehrnreich 1998).

Warnaby and Woodruffe (1995: 261-262) mention co-operation and integration with the aim of ensuring continuity of supply of exclusive merchandise as an appropriate response towards suppliers when trying to achieve a competitive advantage in retailing. Private labels change the relation between retailers and manufacturers by positioning retailers both manufacturers' immediate customers and their competitors for end consumers' purchases. Retailers can leverage PL brands to strengthen their bargaining position against the suppliers (Morton & Zettelmeyer 2000: 1-2). PLs emphasize the need to form longer and closer cooperation between retailers and suppliers. As the products are more directly linked to retailer's identity, retailers need closer involvement in the suppliers' operations. (Ehrnreich 1998: 88). "The increasingly direct relationship being established between food retailers and consumers through the development of private label ranges and the introduction of loyalty schemes" poses a threat on the suppliers as the brand loyalty erodes. (Ehrnreich 1998: 9).

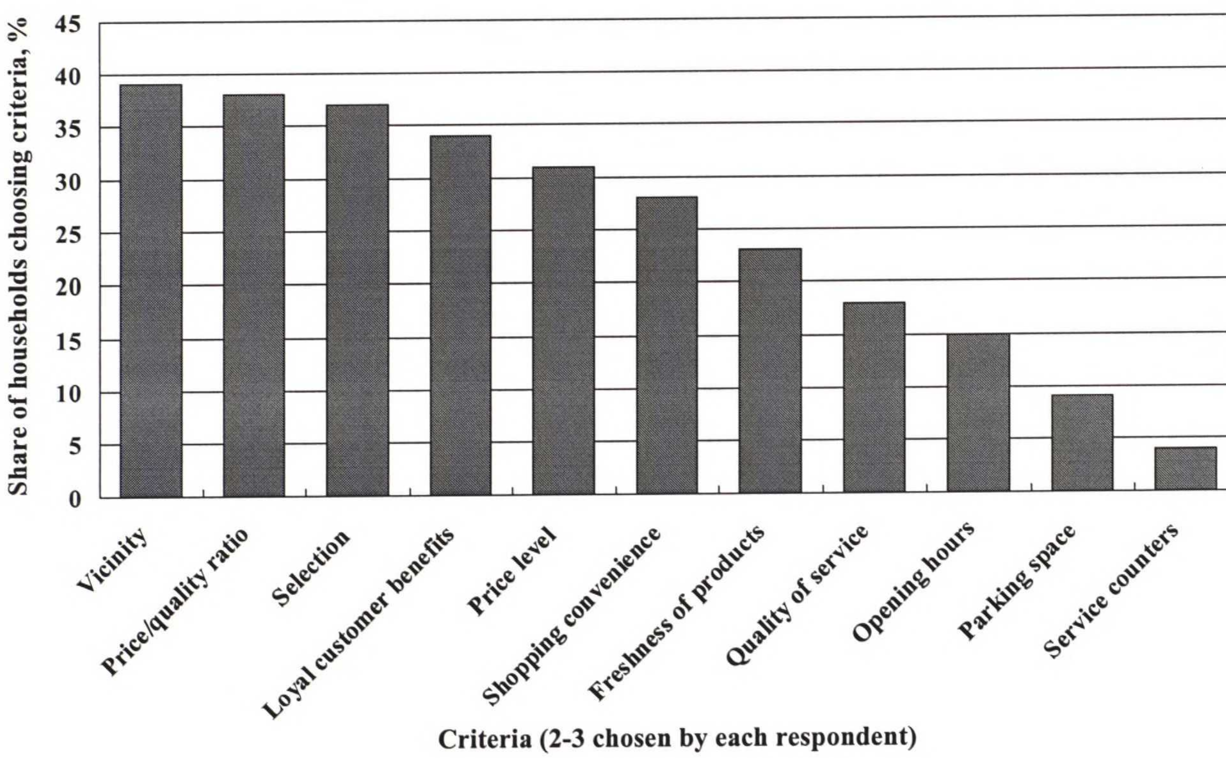
2.3. Customers

The overall aim of customer strategy in retailing is to build a solid customer franchise, which increases the visit frequencies, transaction size, and range of purchases of the customer base (Walters ref. Warnaby & Woodruffe 1995: 262). Many interviewees find that a central element determining Lidl's success in Finland is how the consumers adopt the business model of Lidl. I will discuss how the consumers make their store selection decisions, what is the meaning of customer loyalty, and how theories find the industry consolidation to affect consumer prices.

2.3.1. Store selection criteria

The consumers make their selection of buying a product or service based on criteria, that may include price, quality, fit, color, durability, warranty, and so on. Uusitalo (1998: 177) suggests that the most important attributes in store preferences are product availability, product quality, fresh products, and service. However, she concludes that price does not seem to affect store preferences towards stores partially because there are no clear price differences among the otherwise preferred stores. Marjanen's (1997: 154-155) study suggests the range of goods, price, and distance as the most important variables in store choice in Finland. When selecting a store for regular shopping, vicinity was number one criterion. Price seems to play a central role for consumers when choosing the store for regular daily consumer goods purchases according to an A.C. Nielsen (ref. Finnish Food Marketing Association 2001) survey (figure 5). Number one criterion for Finnish consumers is vicinity of the outlet supporting Marjanen's view (see section 2.3.1.), but price and price-quality ratio follow close. The importance of price and price-quality has a slight declining trend when compared five years back, whereas the selection and loyal customer benefits are becoming more central.

Figure 5. Criteria for selecting a regular shopping store in Finland, 2000



Source: A. C. Nielsen Finland ref. Finnish Food Marketing Association 2001.

The relative importance of each criterion is determined by the consumer, and different consumers place different weights on the attributes thus leading to heterogeneous consumer preferences. (Berman & Evans 1995: 207). These variations create demand for several types of business models, and can play an important role in success or failure of a store format.

Customers buy from the firm that they believe offers they highest customer delivered value[8], i.e., the difference between total customer value and total customer cost. Companies can improve their offer in two ways. First, they can increase total customer value by strengthening or augmenting the product, services, personnel, or image benefits of its offer. Second, they can reduce total customer cost by lowering their prices or by lessening the customer's time, energy, and physic costs. (Kotler & Armstrong 2001: 668-670).

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[8] I will use the term "value proposition" to describe customer delivered value from retailer's point of view.

2.3.2. Customer loyalty

Not only the customer preferences and company's value proposition, but also customer loyalty affect the abilities of retailers to win customers over. Customer loyalty is a valuable tool for increasing market share and defending the company's competitive position. Customer loyalty becomes more and more important as competition increases and products continue to commoditize (Ehrnreich & Ackrill 1998: 75). Loyal customers purchase more on average, are less price sensitive, and provide companies with important information for optimizing product assortments and marketing (Finnish Food Marketing Association 2001: 17; Kotler & Armstrong 2001: 671). However, numerous studies reveal low store loyalty and significant switching for grocery store purchases (Poplowsky Leszczyc et al. 2000: 324). Furthermore, the wheel of retailing theory (see section 2.5.1.) suggests that price sensitive shoppers are usually not store loyal, and thus likely to switch for firms with lower price levels.

Common ways to increase customer loyalty are loyalty schemes, such as loyalty cards. K-ryhmä has reached the widest penetration with Kesko's Plussa-card, which has currently almost 2.7 million cardholders (Kesko 2002a: 4). S-ryhmä has also succeeded well, with nearly a million customer owners (Jouslehto 2002a). Overlaps in card ownership are increasing, from 1998 to 2001 households holding two of three major loyalty cards (K-Plussa, S-Etukortti, and Ykkösbonus) increased from 33% to 38% and all three cards from 14% to 23% (A.C.Nielsen 2002). This can be a sign of decreasing customer loyalty or merely a rise in overall penetration. Rintakoski (2002) considers it unlikely that loyalty will increase in the future. Operating in multiple businesses seems to give better opportunities for companies to increase the attractiveness and thus the penetration of their loyalty schemes. Loyalty programs require high investments, and it is hard for small chains or independents to operate loyalty programs (Ehrnreich & Ackrill 1998: 78). Ehrnreich and Ackrill (1998: 78) comment that collectives or buying groups have difficulties in operating loyalty programs, as each of the organizations tend to have their own programs. Another way to build loyalty is private labels. Own brands can be used to give customers "unique products and value, visible links to the store or chain identity and direct links to loyalty card programs" (Ehrnreich & Ackrill 1998: 79).

2.3.3. Industry consolidation and consumer prices

There are contradictory views about how growth of large retailers and increasing consolidation and market power towards suppliers will affect the consumer prices. Countervailing power hypothesis sees consolidation as a socially desirable development for the consumers, lowering the price level. According to the hypothesis, the market power of large retailers is really a countervailing power against manufacturers exercised on behalf of consumers, and the lower prices will be passed on to the customers. Ungern-Sternberg as well as Dobson and Waterson (ref. Chen 2001: 6) find that increased consolidation will not necessarily lead to lower prices for consumers, but might under certain conditions even lead to higher prices. Chen remarks, that both the views lack theoretical support and should be viewed with a certain degree of skepticism. Chen's own model suggests a decline in consumer prices as "the supplier, in an attempt to counter the rise in the power of the dominant retailer, reduces the wholesale price to other retailers." (Chen 2001: 4-31). Aalto-Setälä's (1997: 45) model suggests that large retailers in Finland have lower costs and also mark-ups, thus leading to lower consumer prices. When evaluating the impact of Lidl's market entry on consumer prices, I will result in examining empirical evidence from other European markets and expert opinions due to lack of consistency in the theoretical research.

2.4. Competitive advantage

Competitive advantage determines how strongly Lidl's market entry can affect the Finnish DCG industry. In order to evaluate the impacts, I will need to analyze the sources and relative strength of Lidl's competitive advantage as well as the incumbents' competitive advantage. Porter (1984: 11-16) distinguishes three generic competitive strategies: cost leadership, differentiation, and focus, consisting of cost focus and differentiation focus. *Lidl deploys a cost focus strategy, providing its services for a focused customer segment on a low cost structure.* Many incumbents have also pursued a cost leadership strategy, but not to the same extent as Lidl. The competitors have neither been able to build clear differentiation strategies as implied by Koskinen (2002). As figure 13 illustrates, Lidl's market entry will highlight the lack of clear positioning strategy of majority of established competitors. As industry matures, opportunities for establishing competitive advantage tend to shift from differentiation-based factors to cost-based factors (Grant

1998: 296), thus providing a favorable environment for Lidl's approach. Some sources of competitive advantage in DCG retailing will be discussed in the following.

2.4.1. Economies of scale

Economies of scale are one source of cost advantage, providing higher profitability for larger retailers (Gale & Branch ref. Aalto-Setälä 1999: 57). I will discuss the rationale behind pursuing scale economies as well as how alliances can be leveraged to achieve lower costs in purchasing.

2.4.1.1. Benefits from economies of scale

Dodgson (1999: 26-28) lists four main reasons to pursue scale economies in retailing:

1) Large scale companies benefit from *larger purchase volumes* in forms of lower prices, which can be transferred into lower consumer prices or retained as higher profits. The effects of purchase volumes can be substantial, as shown when Wal-Mart's acquisition of German Wertkauf reduced the acquired chain's purchasing prices by 15%[9] (Gurdijan et al. 2000: 71). According to Gurdijan et al.'s (2000: 71) case examples of domestic acquisitions in Central Europe, purchasing costs of the acquired company have reduced by 1-2%.

2) Scale increases *resources for branding and private label development*. Scale in PL development will be further discussed in section 4.1.4.3.

3) Scale provides a *greater leverage for investments* into technology and logistics. Standard & Poors (2001: 6) emphasize the need to leverage large investments in the increasingly technology oriented and capital-intensive food retail as a motivation for consolidation.

4) Large companies can achieve *efficient scale in different store formats*. One way to grow market presence, scale, and profitability in saturated markets is to operate in multiple formats (Dodgson 1999: 26-28). Arthur Andersen (2001: 12) lists several benefits from operating both in large and convenience store formats. The benefits include leveraging similar operations and experiences, significant synergies in procurement, marketing, systems, and administration and opportunities to grow the top and bottom lines of mature markets. All of the top five Finnish

[9] One interviewee questioned whether the actual savings were that high.

companies operate large and small formats. In top seven, Rautakirja has focused to compete exclusively in kiosks and Stockmann in department stores.

Reduction of relative cost of head office and support functions is a further motivation for consolidation (Retail Intelligence 2001a: 6; Rudolph 2000: 6). For hard discounters, such as Lidl and Aldi, the scale economies mostly result from standardized store formats and assortments, as well as centralized management and rapid expansion (Rudolph 2000: 12).

2.4.1.2. Purchasing alliances

Companies can seek scale economies in purchasing through combined procurement processes. It is particularly useful for small countries to undertake joint buying in order to obtain the lowest possible supplier prices. (Dodgson 1999). Small domestic market size gives the retailers "incentives to combine and purchase greater volumes together, even internationally" for companies in small countries such as in the Nordic (Ehrnreich 1998: 97; Ehrnreich & Ackrill 1998: 66). We can see evidence of joined purchasing already in the Nordic markets (European Retail Analyst 2001). In Belgium, the local retailers have responded to foreign market entrants by joining forces with foreign retailers for joint or franchised activities (Ehrnreich & Ackrill 1998: 88).

Gurdijan et al. (2000: 72-73) remind that deriving savings from international purchasing is challenging for three reasons. First, national differences in rebate systems make creation of single comparable database difficult. Large manufacturers are also unwilling to give up their historical price differentials among countries. Second, the assortment overlaps in countries can be small. Third, International cooperation with suppliers has so far created the fewest savings in purchasing, even though opportunities to achieve this can been seen from evidence in other industries.

2.4.2. Value chain efficiency

In addition to scale economies, efficiency of value chain activities contributes to a cost advantage. More efficient value chain reduces costs in inventories, transport, administration, and financing (Ehrnreich & Ackrill 1998). Here, I will discuss few ways how efficiency can be increased in the DCG industry value chain: efficient consumer response (ECR), chaining, and horizontal cooperation.

2.4.2.1. Efficient consumer response

ECR is a strategy in DCG industry, where distributors and suppliers cooperate closely to generate value for the customer by creating a responsive, customer driven system. It aims at comprehensive optimization of the supply chain to minimize the stock levels as well as costs and maximize product availability and customer satisfaction (Finne & Kokkonen 1998: 27-28; Home 1998b: 5). ECR is used for reducing supply chain inefficiencies, particularly in logistics (European Commission 1999: 21). ECR strategies are divided into efficient selections, efficient replenishment, efficient marketing, and efficient product launches.

Based on industry sources, Ehrnreich (1998: 5, 103) estimates that 10.8% savings in the product cost can be passed on to the consumer if ECR policies are widely adopted, most savings coming from efficient promotion and continuous replenishment. Finne and Kokkonen (1998: 31) suggest that replenishment accounts for two thirds of the savings. According to European studies, the cost savings from ECR have resulted in opportunities to reduce the consumer prices by more than five per cent (Home 1998a: 74). Fernie's (ref. Akehurst 87 p. 134-147) study reveals that the throughput time of grocery supply chains varies significantly by nation, and substantial savings can be achieved by increasing the efficiency.

2.4.2.2. Chaining

Chained retailers dominate most of the markets in modern retailing. "As the large retailers become more powerful and play a major part in the industry, small chains and independents will lose share and become fewer in number" (Ehrnreich 1998: 142). Chained retailers generate vast majority of sales also in the Finnish DCG market. In retailing, it is essential to segment the market optimally, and develop concepts that serve the needs of the market segments as efficiently as possible. Too broad market segmenting ignores needs of some consumers, and too narrow segmenting becomes expensive to operate (Yli-Kovero 2002b; Ehrnreich & Ackrill 1998: 137). Different market segments are served through different chains. It is less viable to go after the whole market with a uniform approach given the emphasis on differentiation in retailing (Ford ref. Warnaby & Woodruffe 1995: 262). Retailers need to develop their chain concepts according to the changing environment.

The main benefits from chaining are increased market power and reduced costs (LTT 1994: 8-10). Chaining decreases costs through joining activities, increases value chain efficiency as well as the ability to scale the business model, enabling for faster growth, and strengthens the brand image. Chains do not only provide more competitive prices, but also better logistics, good outlet locations, and better accessibility to the customer (Tahvanainen ref. Pöysti 2000). Lack of chaining leads to selection diversification, higher turnover times, irrational use of shelf space, and decentralized, less efficient purchasing (Interview).

Chaining allows for reaching both, economies of large and small scale and localization and centralization (LTT 1994: 9; Tupamäki 2001: 14). It gives better opportunities for internationalization, as the local companies know better the local environment and the consumers, but they can simultaneously reach the expertise and benefits of cooperation through the international chain (Santasalo & Hintsanen 1992: 16). Replicability is one reason why most of the entrants penetrate new markets with chains (Tupamäki 2001: 14). Chaining can be seen as a way of managing outlet network as standardized procedures save management attention and costs. From the chain retailer's point of view, reduced independence and flexibility are downsides of chaining.

2.4.2.3. Horizontal cooperation

Kauhanen (2000b) presents two extreme views of future development of Finnish retail market. One where the international giants capture all the markets, and another where there still will be local retailers. In the latter scenario he sees rational, that the companies divide the activities horizontally, one company taking care of the logistics, another gets the store locations, etc. Dranove et al. (1998: 1032) note that strategic groups could have group-level market power if the managers recognize their mutual interdependence. One way of creating such interdependence could be horizontal cooperation. Purchasing alliances are a commonly adopted form of horizontal cooperation, but opportunities for cost savings exist also in other areas. Home (1995: 5) sees competitive pressure as the motive leading competitors to seek modes of cooperation, such as Tradeka and SOK's Inex Partners. Further intensifying competition could entice the retailers to develop cooperation beyond current scope. Paul-Louis Halley, chairman and CEO of Promodès (ref. Abate 1997), sees organizing distribution network increasingly important for cost reduction as sourcing becomes more global. This could mean sharing a logistics network with several retail chains.

2.4.3. Differentiation

Kalish (1998: 19) finds two main strategies, how hypermarkets can encounter the threat of hard discounters. First, attempting to acquire hard discounters, which is clearly out of question for the incumbents. Second, emphasizing their differentiated position from the discounters by offering a broader, differentiated selection and more convenient, one-stop shopping. Differentiation is an important defensive strategy for the competitors as Lidl enters the Finnish market. Dick (1999: 20) associates the level of differentiation with ability for retail chain to move away from head to head price competition.

In a mature industry, "the trend towards standardization narrows the scope for differentiation and reduces customer willingness to pay a substantial premium for differentiation." Grant (1998: 299-300) sees that clear differentiation through variety, style, and ambience has contributed to the sales growth and profitability of a number of retailers[10]. In consumer goods, maturity often shifts the focus of differentiation from physical product characteristics to image. The quest for differentiation in mature industry requires innovation in terms of image, retail ambience, segmentation, or new forms of product delivery.

In this report, I will discuss the areas where Finnish retailers can differentiate themselves against Lidl. I will focus on the demand side analysis of differentiation, examining the potential to differentiate in order to increase customer satisfaction or lower the customer's costs (Grant 1998: 218; Porter 1979: 131). According to Porter (1985: 14), "differentiation can be based on the product itself, the delivery system by which it is sold, the marketing approach, and broad range of other factors." Grant (1998: 191) lists branding, advertising, design, service, and quality as key elements of differentiation strategy. The main components of differentiation in DCG retailing are location, store size, range, ambience, and private labels (Dick 1999: 20).

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[10] Examples are from industries other than DCG, but can be thought to apply for DCG industry as well.

2.4.3.1. Store formats

Store formats are a fundamental element of retailer strategy. Store formats reflect the basic strategic choices made by retailers: which customer segments they operate in, what is their generic competitive strategy, and whom they compete against. Store format choice directs strongly the store size and location as well as product offering decisions. "Focusing on a particular aspect of the retail mix (e.g., service or price) means that retailers can compete on highly diverse dimensions" (90 p. 323). Each store format sets distinct requirements on the skills and asset base of the retailers competing in those categories. Different segments vary in growth rates and structure thus making choice of segments a key strategy issue in mature industries (Grant 1998: 299).

2.4.3.2. Product offering

Differentiating through product offering is strongly linked with store formats and products. "The potential for differentiating a product or service is partly determined by its physical qualities" (Grant 1998: 219). DCG products are divided into branded and private label products. In branded products abilities for retailers to differentiate are practically non-existent. The Finnish retail sales are dominated by branded goods, which partially contributes to the low level of differentiation between the companies[11]. In fact, PL penetration is a key measure used to evaluate the level of differentiation in a market (Bell 1999: 20-21). Private label products are seen as a tool for differentiation, increasing customer loyalty, and potentially profitability (Ehrnreich & Ackrill 1998: 162), thus offering attractive opportunities for retailers. Reducing costs and raising differentiation simultaneously is possible by using practices that are both, more efficient and effective (Porter 1985: 18). In DCG industry one such practice is private label development. In many countries, such as UK and Germany, PL products are a common form of differentiation. One interviewee found that differentiation between competitors is very difficult as the chains are using similar methods. He adds that product segments are used for making small differences.

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[11] The central arguments in Koskinen's (2002) thesis were, that the retail chains operating in Finland are not clearly positioned, and the level of differentiation between chains is low.

2.4.3.3. Differentiation through advertising

Advertising is a part of the promotial mix in retailing and can be used to build a differentiated image of the retailer. Advertising can help to, e.g., develop and/ or reinforce a retailer image and inform customers about goods and services and/ or company attributes (Berman & Evans 1995: 580-582). Advertising can be used as a tool for branding. Consumers view a brand as an important part of a product or service, and branding can add value to a product or service (Kotler & Armstrong 2001: 301).

2.4.4. Dynamic approach to competitive advantage

Static evaluation of competitive advantage is not adequate, but also sustainability of competitive advantage needs to be considered. Sustainability of relative differentiation advantage depends on its sources. Mobility and entry barriers, cost advantages in differentiation, and switching costs are some factors increasing sustainability. (Porter 1979: 112-115, 158-159). In DCG retailing, such barriers could be scale economies, store locations, company image, and customer loyalty. To take into account the dynamic nature of competitive environment and sustainability of the competitive advantages, I will assess the opportunities for Finnish incumbents to deploy defensive strategies in the empirical part as mentioned earlier.

Company's responsiveness to external changes can contribute to its competitive advantage. Responsiveness to the opportunities for competitive advantage requires information and flexibility of response. *Information* is necessary to identify and anticipate external changes, thus highlighting the company's environmental scanning capabilities. Ability to swiftly redeploy resources to meet the changes in the environment provides for *flexibility of response*. (Grant 1998: 176).

2.5. Industry evolution

Industry evolution theories will enable us to view competition as a dynamic process compared to the static approach of Porter's five competitive forces framework. Forces of competition and changes in technology and environment drive the industry evolution. Grant (1998: 241) suggests that there are some common patterns in the industry development, and therefore examining evolution theories could provide a further insight into understanding the effects of Lidl's entry.

2.5.1. Retail evolution theories

Brown (1987: 6) categorizes retail evolution theories in three groups. "The first, environmental theory, contends that changes in retailing are a function of developments in an institution's operational milieu. Cyclical theory, the second and by far the most common perspective, suggests that changes take place in a rhythmic fashion and is characterised by the recurrence of earlier patterns. The third school of thought, conflict theory, focuses attention on the inter-institutional strife that occurs when novel retail forms first appear." Most of the theories concentrate on explaining the evolution of different retail formats, such as the ones described below.

Brown (1987: 9-10) considers w*heel of retailing theory* as the most famous and frequently cited theory of institutional change. It is an example of cyclical theories. All new retail concepts start out as low cost and low price. Over the time retailer 'trades up' by enhancing products, service, and ambience thus making itself vulnerable to new discounters with low-cost formats. (McNair 1958 ref. McGoldrick & Davies 1995: 214; Berman & Evans 1995: 135; Brown 1987:10-12). Brown (1987:10-11) suggests that the wheel pattern is apparent in many economically advanced countries, whereas the entrants in developing nations are often introduced in the high end. Wheel of retailing reveals three basic strategic positions: low end, medium, and high end. The theory is based on four basic premises (Berman & Evans 1995: 135-136):

1) There are many price sensitive shoppers willing to trade services and convenience for lower price.

2) Price sensitive customers are often not store loyal.

3) New institutions can frequently implement lower operating costs than existing institutions.

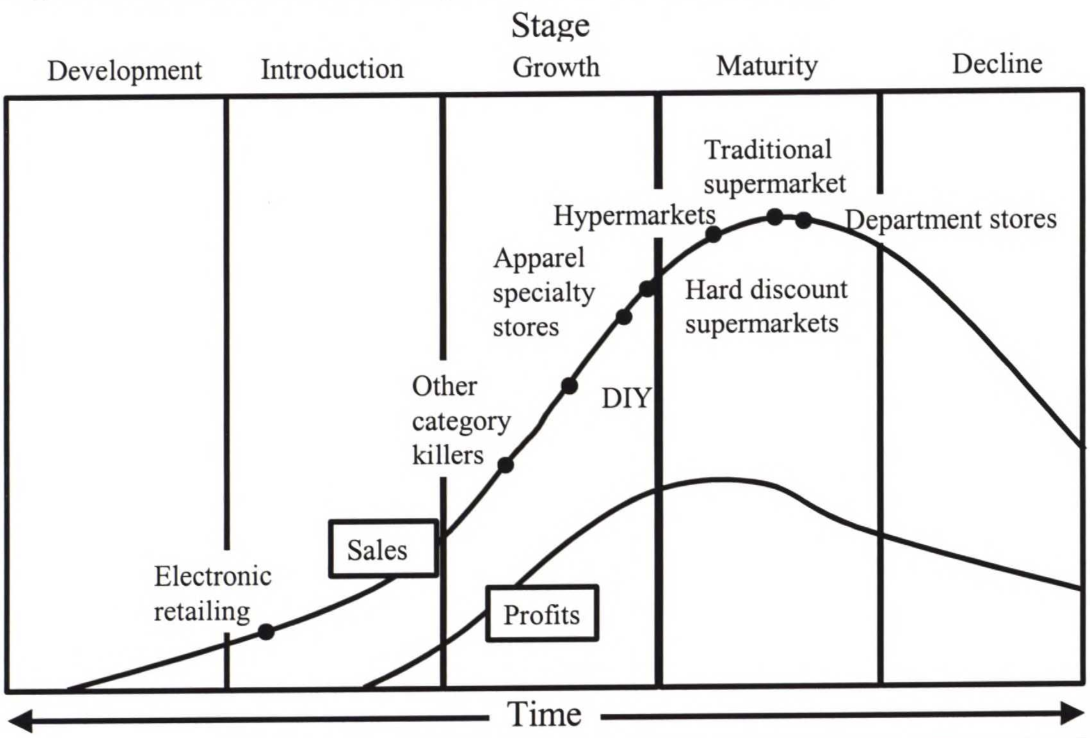
4) Retailers trade up typically in order to increase sales, broaden target market, and improve store image.

Polarization principle contends that the trend towards fewer and larger retail institutions is counterbalanced by a renaissance of the small shop sector. Convenience stores offering a wide range but limited assortment of merchandise in convenient locations are an example of such development. Smaller stores complement, rather than compete with larger formats. (Brown 1987: 14).

Multi polarization model complements the shortcomings of wheel and polarization principles. The wheel and polarization principles fail to recognize the interconnections between the models, whereas multi polarization model suggests that institutional development along any dimension, price, assortment, or size, gives rise to counterbalancing actions. (Brown 1987: 14-15).

Analogical to product life-cycle theory, *retail life-cycle* theory suggests that retail follows stages of birth, growth, maturity, and decline. "Imitators enter the same market during the growth stage, creating competition and, ultimately, reducing profitability." (Davidson et al. ref. McGoldrick & Davies 1995: 214). Environmental theory sees the life-cycle to be a direct response to environmental circumstances (Arndt ref. Brown 1987: 6). Different store formats are in different stages in the cycle. Kalish (1998: 8) depicts the development of different formats in Europe as shown in figure 6. However, there are geographical differences (Grant 1998: 246), as discounting is currently just entering the growth phase, e.g., in Finland, but has reached a mature stage in a number of countries, such as Germany and Norway. Grant (1998: 246) sees that as industry life cycle stages differ by countries, *multinationals can exploit such differences by developing new products* (or concepts) *and introducing them into the advanced industrial countries, and then leveraging them in growth markets*.

Figure 6. Store formats according to stage of life-cycle, Europe



Sales	Low/ growing	Rapid acceleration	High, leveling off	Declining
Profitability	Negative to B/E	High yield	High, declining	Low to B/E
Patronage	Innovators	Special need	Broad market	Special need
Competition	None	Limited	Extensive	Intensive

Source: Kalish 1998: 8.

Cycle of retail concentration explains why the industry consolidation increases. The buying power of large retailers enables them to obtain favorable prices, which their smaller rivals are unable to match. This advantage enables the largest retailers to increase market share by offering lower prices leading to a cycle of concentration at the expense of small-scale competitors. (McKinsey & Company ref. Brown and McDonald 1994: 124-125). This will raise the barriers for new entrants.

2.5.2. Foreign entrant affecting industry evolution

Research in the area of how foreign entrants affect a domestic industry seems to be fairly limited. Most research was found concerning the banking sector, such as Claessens et al. (1998), Hermes and Lensink (2001), and Clarke et al. (1999). Research has been conducted also in the car industry, Geroski and Murfin (1991). In retail sector, no such research was found. Related studies include Burt and Sparks (1995) examining the institutional development of British discount sector, Goldley and Fletcher (2000) focusing on the reasons for foreign direct investments into British retailing, and numerous authors discussing the internationalization of retailing (e.g., Akehurst & Alexander 1996). The key theory in this part will be introduced mainly from the banking sector, and at the end of the report, I will evaluate its applicability to the retail sector.

In academic literature, it has been discussed that the growth of foreign bank operations has three major consequences for domestic banking markets. "First, foreign banks will affect competition. Second, they will influence the efficiency of domestic banks. Third, they will have an impact on the stability of the domestic banking system." (Hermes & Lensink 2001: 2). Claessens et al. (1998: 18) emphasize the causal relationship between the first two points. Hermes and Lensink (2001: 3-8) explicate, that foreign banks put pressure on domestic banks to give up their previously high income and profits. Foreign banks also put pressure on domestic banks to become more efficient and allow for copying modern banking techniques thus reducing costs. Foreign competition can have both, positive and negative effects on the domestic banks depending partially on the extent of competition on the domestic market. At low levels of foreign bank numbers and/ or market shares the positive spillover effects on profitability, costs, and income may outweigh the negative impacts of increased competition. As the number and/ or market share of foreign banks becomes higher the spillover effects will be outweighed and the impact will be negative.

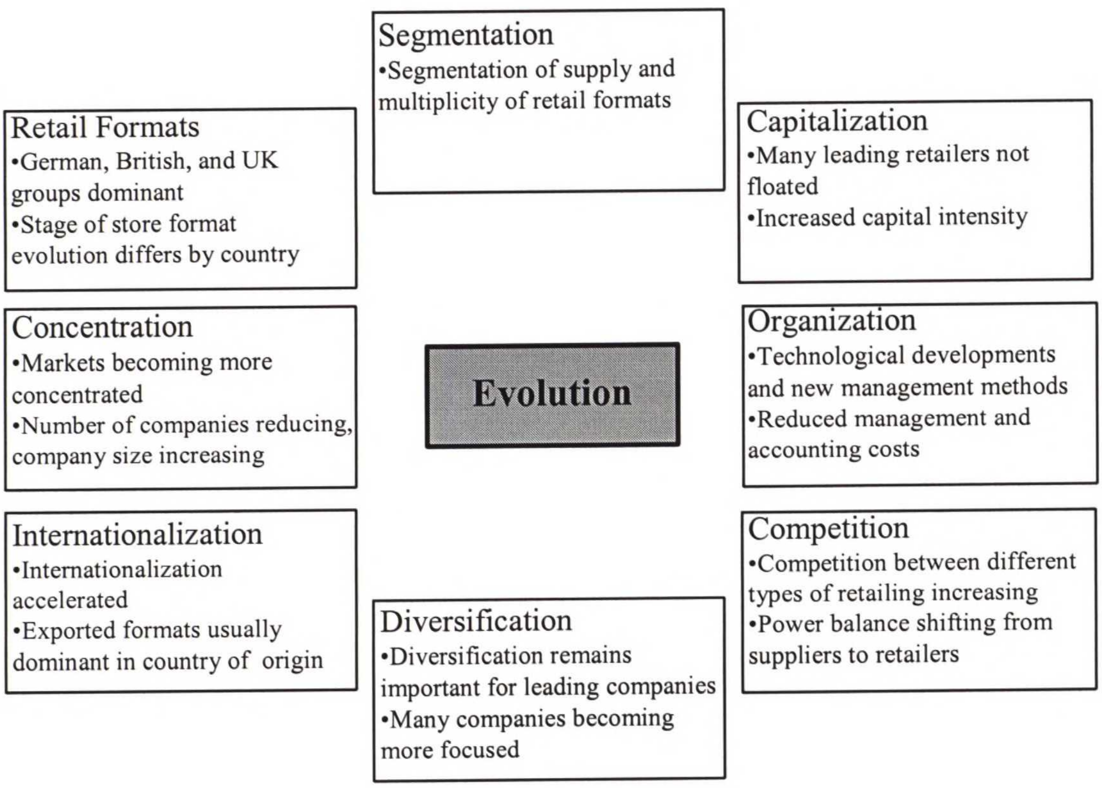
The empirical research of Claessen et al. (1998: 18) suggests that foreign bank entry has positive welfare implications for banking customers through improved functioning of national banking markets. Levine (ref. Claessens et al. 1998: 2) adds that foreign banks may improve the quality and availability of financial services in the domestic market.

Seabright (1996: 546-548) suggests that market entry of one company can easily induce the entry of another company when the market elasticity of demand is unknown for the companies. Observations of profitability of the first company's market entry thus signaling the market elasticity can encourage another company to enter the market as well. This could be thought to be analogical with observing positive consumer reactions potentially attracting further market entrants. E.g., Finnish DCG industry lacks hard discounters, and the discounter chains are unaware how the consumers will adopt the new store format before the first company has established its discounter stores. Other reasons why a market entry might attract or more like expedite other entrants especially with similar strategies is entering the market before the first mover has been able to strengthen its market position thus increasing the entry barriers.

2.5.3. Cross-border convergence

Americanization theory drawing upon Mannheim's rationalization thinking suggests, that rational systems tend to bring about homogenization (Ritzer 1998: 88). System rationalization could be an important factor driving European retail markets more convergent and homogenous. Rationalization could be facilitated by international retailers entering new markets, as suggested in section 6.2.3. McGoldrick and Davies (1995: 17-24) identify convergent evolutionary trends in a number of areas in the sector. The convergent trends "involve the sector and its concentration, retail formats and their organization, operators and their strategies". The sector is becoming increasingly concentrated with large, international groups dominating. Diversified demand and market fragmentation have led to segmented markets and diversified store formats. Competition between different store formats is intensifying. I will later use McGoldrick and Davies' framework in figure 7 to assess how Lidl's market entry will increase the convergence between the Finnish and west European DCG market.

Figure 7. Convergent trends in west European retail



Source: Adapted from McGoldrick 1995: 17-24.

2.6. Positioning of foreign entrant to industry dynamics

This study examines the dynamics and evolution of Finnish DCG industry, focusing on the role Lidl's market entry will play in them. In this chapter, I have discussed the relevant theory elements concerning competition and industry evolution, and now I will combine these elements into a model. Based on the empirical research, I will also propose a model for examining the indirect impacts a foreign entrant has on an industry.

The direct and indirect changes can be thought to occur in three phases. First, *incumbents preparing for the market entry*. S-ryhmä's piloting with Sentti can be considered to belong in this phase, as the group collects information from the market segment where Lidl will enter. Several incumbents have prepared for the entry by having recently launched new hard discount private label product lines. Second, *foreign entrant entering the market*. This is the most visible phase, characterized by Lidl's store openings and immediate competitor reactions, such as potential price reductions in the stores in the vicinity of Lidl's outlets. Third, *further competitor reactions and entrant moves*. Competitor reactions will be discussed in section 2.6.2. Lidl will also actively develop its strategy and operations in the market, such as opens new outlets and develops its product offering, thus causing additional changes in the industry.

2.6.1. Dynamic model for examining industry competition

Figure 8 depicts a framework for examining how a foreign entrant affects industry evolution. Suppliers, established competitors in domestic market[12], and consumers form the industry value chain. Strategic dimensions can be used to categorize the established competitors into strategic groups. Competition can occur within the groups as well as between the groups. Competitor analysis and assessing response profiles can be used to examine the competition and expected retaliation. Entry and mobility barriers should be assessed on the strategic group level. E.g., industry consolidation and private label development affect the dynamics and profit distribution between suppliers and wholesalers. Similarly, industry consolidation and customer preferences affect the dynamics and profit distribution between retailers and consumers.

Established competitors are vulnerable to entries of foreign established retailers. Foreign entrants[13] evaluate desirability of market entry based on market attractiveness. After a market entry decision, the entrants have a direct impact on the competition, suppliers, and consumers. Industry evolution derives from structural and dynamic changes in the industry. Foreign entrants influence the industry evolution both directly and indirectly. The strength and nature of the impact on industry evolution depends on the entrant's competitive advantage in relation to the

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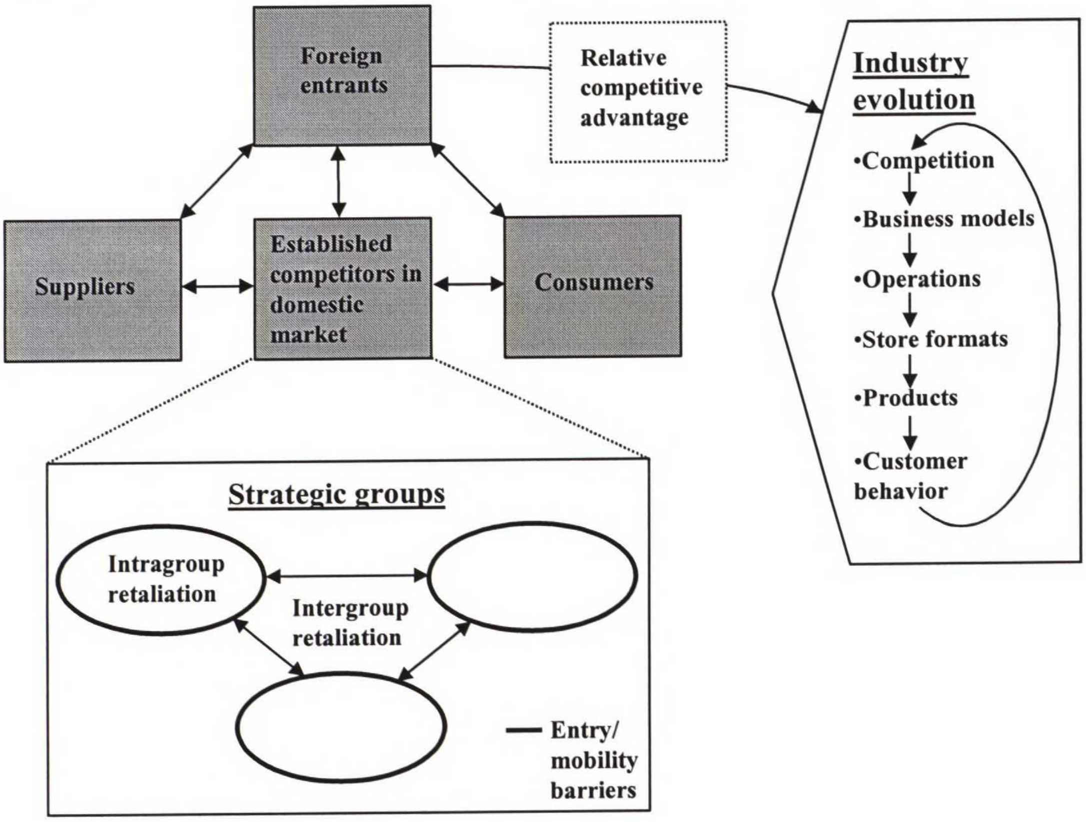
[12] For practical purposes, I use the term "established competitors" to refer aggregated both to retailers and wholesalers to distinguish the relationship with suppliers.

[13] By foreign entrant I refer to DCG retailers that have established operations in countries other than Finland and are entering or potentially entering the Finnish market. Compared to Porter's five competitive forces framework, substitutes and new entrants without established DCG retailing operations are excluded. Lidl's products are substitutes with the established competitors and its market entry does not likely affect the emergence of new substitute products. The only effect it might have, is to provide better protection against substitute products as the industry efficiency likely enhances and price level decreases. In a long run, higher level of competition might, however, motivate retailers to develop alternative distribution channels, such as online storefronts. High entry barriers, e.g., economies of scale, make entry of new entrants unlikely. Even though it is possible that new entrants might diversify into the industry through an acquisition of existing competitor, such possibility will not be assessed here.

established competitors. Industry development takes place on various dimensions, and affects the industry dynamics throughout the value chain.

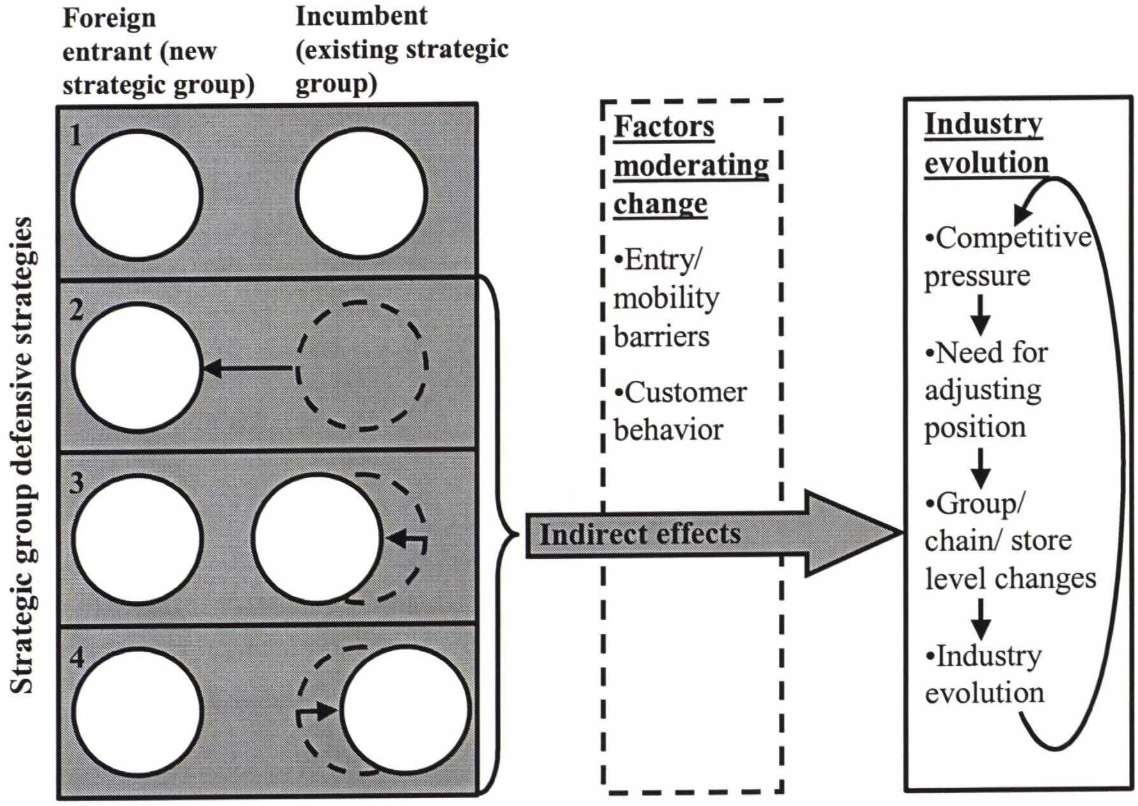
Figure 8. Dynamic model for examining industry competition



2.6.2. Model for examining indirect effects of foreign entry on industry

In this report, I will suggest that Lidl's entry will form a new strategic group in the Finnish DCG retailing industry. Figure 9 illustrates, how formation of a new strategic group leads to incumbent defensive strategies that should be assessed in order to find out the indirect impacts of the market entry. Even though the defensive strategies are discussed to result from an emergence of a new strategic group, similar defensive strategies are applicable to a situation where a foreign company will operate within an existing strategic group. Then the focus should be placed on those dimensions where the foreign entrant possesses a relative competitive advantage.

Figure 9. Model for examining indirect effects of foreign entrant on industry



When a foreign entrant establishes a new strategic group, the incumbents operating within another strategic group have four defensive strategy options. Each group, chain, or store in the strategic group can deploy these strategies, and collective adjustment of position can shift the position of an entire strategic group[14].

1) *Status quo, not changing one's position.* This will result in a loss of market share if the customer segments are overlapping and the entrant gains market share, as will happen in Lidl's case. This is a viable strategy only if repositioning is more costly than the loss of market share or it is impossible due to mobility barriers.

2) *Entering the new strategic group.* Engaging in a head on competition will enable the incumbents to capture a part of the market share otherwise won by the new strategic group and

[14] For illustrative purposes, I have depicted the defensive strategies as a shift of the entire strategic group in figure 8, even though they are actually strategies for each group, chain, or store operating within the strategic group.

hamper the market penetration of the entrant. Evidence from such defensive behavior can be found from a number of European markets and also to some extent from Finland with S-ryhmä's Sentti.

3) *Adjusting position towards the new strategic group.* Decreasing the relative competitive advantage of the entrant by developing those dimensions where the customers perceive the new strategic group more attractive. Here, such actions could be adopting hard discount private label ranges in existing store formats or reducing prices.

4) *Adjusting position away from the new strategic group.* Increasing own relative competitive advantage by further improving own value proposition in those dimensions where the incumbents already have an upper hand. Improving customer service and high end product ranges could be such strategies for the established retailers.

The strategies are not mutually exclusive, and can in fact be more effective when deployed simultaneously. Based on the interviews, the strategies 3 and 4 are the most relevant when examining the impacts of Lidl's entry. The strategies mostly take place only in certain elements of the incumbent operations. Strategy 2, entering the new strategic group will also be discussed. Strategies 3 and 4 can be thought to be analogical to strategies for encountering the threat of substitute products as indicated by Porter (1980: 166).

The defensive strategies 2 - 4 combined result in the indirect impacts a foreign entry has on industry evolution. Emergence of a new strategic group intensifies the competition and changes the industry structure. In order to improve their competitiveness, the incumbents need to adjust their position resulting in changes in group or chain level strategies and operations. When assessing opportunities for position adjustments, not only the position vis-à-vis the new strategic group should be considered, but also vis-à-vis the existing ones. The group or chain level changes drive the industry evolution, which again alters the competitive landscape. As Lidl introduces a new strategic group[15] in the Finnish market, the need for repositioning for the incumbents and thus the impacts on the industry evolution are often greater than if a company would enter the market with business models that are already established in the market.

[15] E.g., Alepa has formerly operated in the discount sector, but currently there are no DCG chains operating with similar business models as Lidl (see figure 12).

Some factors can moderate the changes. Entry or mobility barriers, such as specialized assets or legislation, can limit the opportunities for the incumbents to deploy defensive strategies and pursue the benefits gained from them. Customer behavior is a key element in assessing the need for adjusting one's position. It determines the relative attractiveness of the new strategic group and whether the consumers will adopt the new business model, thus affecting the cost of not engaging into defensive actions.

3. RESEARCH METHODOLOGY

Here, I will describe the research process, discussing the research design and the sources used as well as assessing the validity of this study. I will conclude with illustrating the report structure.

3.1. Research design and choice of methodology

In the following, I will discuss the research design and the methodology used in this research. I will provide arguments for choosing this particular approach, and discuss the viability of alternative approaches.

3.1.1. Research design

This is a qualitative study that can precede further research in numerous areas (see section 6.3.). As a typical qualitative research, this study examines multiple simultaneous factors and is highly bound to the context. A strength of qualitative researches is further developing theories (Uusitalo 1991). I will develop theories and patterns further in order to achieve a better understanding of the topic and verify the results in order to increase the validity of the study. (Creswell ref. Hirsjärvi & Hurme 2000: 25). There are two ways how a quantitative research could have been used instead. Observations of Lidl's market entry on benchmark markets could have been used to build a model of the impacts on defined dimensions as a function of market characteristics and Lidl's strategy, but this would require excessive data gathering and would provide a narrower view on the impacts and the causal relations. Quantitative research could be carried out to examine the realized effects ex-post. This would be possible only after sufficient time has passed from the market entry, and would fail to provide inputs for proactive strategy formulation of Lidl and its Finnish competitors at this point, as this study aims to do.

The study has a single-case holistic design (Yin 1994: 38-51). Single case design will highlight the contextual factors. This research extends the previous research to examine the effects of a foreign market entrant on the Finnish daily consumer goods industry. It can be used as a critical case to test how well results derived from banking industry are applicable for a different industry and whether generalizations can be found. High-level comparable analysis will be conducted between effects of Lidl's market entry and selected benchmark cases, such as market entries of Gigantti and Ikea, thus helping to separate the contextual factors from the generalizations.

Underlying holistic theory and holistic benchmarks led to choosing a holistic research design. Holistic design enables to link the industry trends, industry characteristics, and country level benchmarks to the research problem. Industry level approach seemed to be favored by the interviewees as well, as they seemed fairly reluctant to answer how Lidl will affect the business and position of individual groups or store formats. Implications on operational level, how the market entry of Lidl will affect individual retailers, will be considered by relating the industry level implications to the strategic groups of Finnish retailers.

Another alternative would have been to use embedded design and start out from the strategies and operations of established retail groups. Karlöf and Östblom (1993: 70) emphasize that in external benchmarking operations are compared with similar operations outside the company, and the components should be highly comparable with each other. In embedded approach, benchmarking should have been conducted on a company level. Suitable benchmark companies would have been fairly difficult to identify and there would have been problems with data availability and distinguishing contextual factors. When looking at the bigger picture, foreign entrants' effects on retail industry, holistic approach often provides more relevant findings as the research aims to identify the industry level implications. However, this study can also be regarded to have an embedded design where four subunits are used for analyzing defensive tactics. The analysis has been conducted on industry, strategic group, store, and product levels.

3.1.2. Scenario analysis

Understanding the forces that drive industry change is critical for preparing a company to meet the challenges of the future. Grant (1998: 255) points out that shifting from forecasting the future to understanding the future has shifted the emphasis from econometric forecasts to scenario analysis. Porter (1979: 445-446) stresses the increasing uncertainty as an incentive for growing popularity of scenario analysis. Grant defines scenario analysis as a process for thinking and communicating about the future. Kahn's (ref. Grant 1998: 255) definition "hypothetical sequences of events constructed for the purpose of focusing attention on causal process and decision points" emphasizes the causal process how scenarios are formed. Grant (1998: 255) identifies assessing market and industry development's implications for competition and competitive advantage as an area where scenario analysis can be used.

To Porter's (1979: 227-228) view, the appropriate unit for analysis of scenarios in competitive strategy is the industry. Industry scenarios allow firms to translate uncertainty into its strategic implications for the industry. This study will follow the logic of Porter's (1985: 449) model of constructing industry scenarios (figure 10). I have started from analyzing the industry development drivers, and developed implicitly industry scenarios and corresponding industry structures. I have continued by determining the sources of competitive advantage and hypothesizing competitor reactions. I have taken into account these indirect impacts that further cause uncertainties and potentially affect industry structure. Multiple scenario analysis would build two or more distinct and internally consistent views of how the future may look like. Porter (1979: 448) suggests using multiple industry scenarios rather than just one. Instead of building multiple scenarios, I will discuss the most critical factors that can influence the development or the strength of the impacts. In order to translate this study into a strategic planning tool, the constituents should build a set of scenarios based on these critical factors.

Figure 10. Process of constructing industry scenarios

Identify the uncertainties that may affect industry structure

Determine the causal factors driving them

Make a range of plausible assumptions about each important causal factor

Combine assumptions about individual factors into internally consistent scenarios

Analyze the industry structure that would prevail under each scenario

Determine the sources of competitive advantage under each scenario

Predict competitor behavior under each scenario

Source: Porter 1979: 449.

3.2. Sources

One of the strengths of a case study is the ability to use several sources (Yin 1994: 80). The use of several sources serves two purposes in this study. First, availability of data from any single source is very limited concerning the topic. Second, multiple sources increase the validity of the research as discussed more thoroughly in section 3.3.1. Yin adds, that the case study should be conducted time wise relatively close to the objective of the research in order to maximize the availability of sources, as is the case in this research.

I have used three main sources of information in the empiric part: market data, media, and interviews. These sources combined cover the basic methods[16] that can be used in attaining information for competitor analysis. *Market data* consists of analyst reports, annual reports, and central organization, market research company, and competitive authority publications. I have used market data to analyze the DCG industry structure and trends as well as individual companies both in Finland and in Europe. The Finnish *media*, mainly newspapers and magazines have offered views on how Lidl might operate in Finland and how the market entry might affect the Finnish industry. Reuters article database has provided a comprehensive picture of Lidl's operations and their impacts on local industry in different European countries.

During April 2002, I have *interviewed* senior management level representatives from all four largest retail groups operating in Finland in order to hear their views on Finnish DCG retail industry, Lidl's operations, and the market entry's effects on the industry. I have referred to the interviewees anonymously on their request. In order to gain a more objective opinion, I have also interviewed an analyst having followed the industry for over a year. Conducting the interviews provided valuable insights in linking Lidl's entry to the specific characteristics of Finnish market, thus allowing to discuss the matter on a more detailed level and to better calibrate the significances of the impacts. All interviews were carried out as focused interviews in order to highlight the interviewee views and interpretations of the topic (Hirsjärvi & Hurme 2000: 48). Main questions were discussed with most of the interviewees, but due to time constraints each interview focused on selected topics based on the interviewee background, mutually covering the questions listed in appendix 4. The interviews were conducted in Finnish, and the quotations

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[16] Direct information, indirect information, and observation of external factors (Routamo & Routamo 1988 14-15)

referred to in this report have been freely translated. I also conducted a brief telephone interview with Kimmo Rintakoski of A.C.Nielsen concerning customer loyalty. I intended to interview the CEO of Lidl Suomi KY, Antti Tiitola, to hear the market entrant's views, but he turned down my request for an interview referring to the abstinent communication policy of the group, as was predictable beforehand.

Different sources seemed to be useful as apparent biases (see appendix 5 for summary of interviewee views) were distinguishable concerning several sources. The articles written in the Finnish newspapers and magazines seem to have a fairly uniform picture about the effects. This could be explained by the likely similarity of their information sources. The articles discuss the matter in a slightly provocative manner, highlighting the magnitude of the changes. Some of the interviewees found certain media statements clearly exaggerating or even incorrect. However, the competitor interviews revealed an opposite bias for obvious reasons. Most of the interviewees seemed to communicate the impacts of Lidl's entry in such manner that would make the situation seem worse for the competitors. E.g., if a group is strong in store format X, the interviewee saw Lidl to affect stronger the market shares of store format Y and vice versa. I have tried to under weigh such biases when analyzing the findings of the interviewees and critically evaluate the rationalizations of the arguments instead.

For the theory part, I have leveraged academic books, articles, and working papers mostly from the fields of strategy, international business, and marketing. Porter's strategy research has provided the backbone for the theoretical framework. I have complemented the generic research with retail research and analyst reports, thus allowing to discuss the theory from DCG industry's point of view.

3.3. Assessment of the quality of this study

As a scenario analysis, this report contains multiple uncertainties. Here, I will discuss the quality of this report. Uusitalo (1991: 82) associates validity and reliability concepts to a quantitative research, whereas assessability and repeatability of the analysis are more natural concepts in a qualitative research. Validity refers to the ability of the indicator to measure exactly what it is supposed to measure and reliability to non-randomness, i.e., repeatability, of the test result. In a qualitative research, the assessability requirements are similar to validity requirements, and reliability can be understood as a requirement for repeatability of the research. (Uusitalo 1991:

84-85). Yin (1994: 40-41) summarizes four tests that can be used for judging the quality of research designs:

1) Construct validity: establishing correct operational measures for the concepts being studied.

2) Internal validity: establishing a causal relationship, whereby certain conditions are shown to lead to other conditions. Malhotra (1996: 240) regards internal validity as a measure of accuracy of an experiment.

3) External validity: establishing the domain to which a study's findings can be generalized.

4) Reliability: demonstrating that the operations of a study – such as the data collection procedures – can be repeated.

3.3.1. Assessability

In this report, I have discussed how Lidl's market entry will affect the Finnish DCG market on several dimensions. I have analyzed the factors that are driving the industry development and how Lidl's entry will affect them. I have also examined the possible defensive strategies for Finnish retailers and evaluated what the indirect impacts are facilitated by competitor responses. By evaluating the relative competitive advantages, I have assessed the strength of the impacts. I have incorporated industry trends and assessed how the effects will reflect to these trends. By doing this, I have formed a comprehensive picture of what structural and dynamic factors affect the industry development as a result of Lidl's market entry and how.

I have leveraged previous research in order to build a relevant framework for the analysis. However, in order to make the theoretical part more relevant to the study, I have incorporated some data from market sources, e.g., analyst reports, which do not have the same theoretical foundations as academic research has. I have used several sources in order to maximize the validity of information, to obtain various perspectives into the topic, and to allow for recognizing biases of the sources. I have used expert opinions not just to obtain information, but also to test and develop my reasoning. The impact of hard discounter format depends on the nature of local competition and the pace of development in the market (Colla ref. Burt & Sparks 1995: 115). When benchmarking, I have analyzed the underlying conditions for observed effects and related these conditions to the Finnish market in order draw conclusions whether similar effects would occur in Finland. In section 6.1., I have explicitly identified the major sensitivity factors that could have an impact on the materialization of the scenarios.

These measures have been taken to maximize the construct and internal validity of the study, using multiple sources, establishing chains of evidence, and doing pattern-matching and explanation-building (Yin 1994: 33). When examining the opportunities for generalization, high level testing through replication to other markets or industries has been conducted by comparative analysis to previous research or benchmark market observations in order to improve the external validity of the study (Yin 1994: 33, 36). It should be noted, that as Lidl reinforces industry trends (see section 6.2.3.), it is difficult to distinguish to what extent the development is contributable to Lidl's entry. Thus Lidl's role as a development driver might be overly emphasized in this report. Many of the developments described throughout the report would happen even if Lidl would not even the market, but Lidl's entry will to some extent accelerate these trends and increase the rationale behind these developments.

Industry level approach sets certain limitations for the assessability of the analyses. This will mostly affect the strategic group analyses and the comparison of revenue and cost structures. The limitations will be more closely discussed in sections 2.1.1.3. and 5.3.1.2. The limitations of the analyses must be weighed against the use of the analyses, and therefore I have ended up using such analyses in order to gain a broad overview of the situation. A further problem with industry level approach is strong influence of individual competitors, as the industry is very concentrated. This will not affect the validity of this report, as it only aims to recognize the potential directions of industry development and the underlying development drivers. However, if explicitly building scenarios, propensity of individual competitors to engage in defensive actions described in this report influences highly in the probabilities of scenario materialization.

Malhotra (1996: 103) categorizes *inability errors* (respondent's inability to provide accurate answers) and *unwillingness errors* (respondent's unwillingness to provide accurate answers) as response errors. I have chosen industry experts that have a long experience in the industry as interviewees in order to minimize the inability errors. I have taken into account the analyst's limited industry experience when analyzing his answers. I have used an industry level approach to limit the unwillingness errors, and in each interview I encouraged the interviewee to mention whether he was unwilling to discuss some topics.

3.3.2. Repeatability

A major problem in this study is reliability of the data. Lidl has practically a zero disclosure policy concerning the company's operations or plans. The data is obtained using the sources described in section 3.2. As mentioned, the data is often speculative, based on different estimates, and biased by personal views. Some of the data was also controversial. Relying on single data points would enable forming a fairly different picture of the situation. Crosschecking and consensus estimates are used whenever possible, but at times single data points are relied upon requiring that they are in line with the big picture. As discussed earlier, I have tried to filter out personal biases and interests when it comes to both media and the interviews. The lack of data has also resulted in using data from several different years, which was especially problematic when trying to form a comparative picture of Lidl's activities in different markets[17]. It should also be noted, that the results derived from this study only outline scenarios based on causal reasoning and relying on the available information.

According to Malhotra (1996: 103), response errors made by interviewee include *respondent selection errors* (selecting other respondents than those specified by the sampling design), *questioning errors* (errors made in asking questions or not probing for more information when needed), and *recording errors* (errors in hearing, interpreting, and recording the answers). I selected the interviewees by using contacting persons interviewed in media, consulting professor Home as well as other industry experts, and asking the interviewees whether they were the right persons to answer the questions, thus minimizing the respondent selection errors. I developed a comprehensive understanding of the subject by using market sources before designing and conducting the interviews to avoid the questioning errors. I recorded the interviews and wrote down the relevant points of the answers in a categorized form (Hirsjärvi & Hurme 2000: 141-142) according to the recordings immediately after the interviews to reduce the recording errors.

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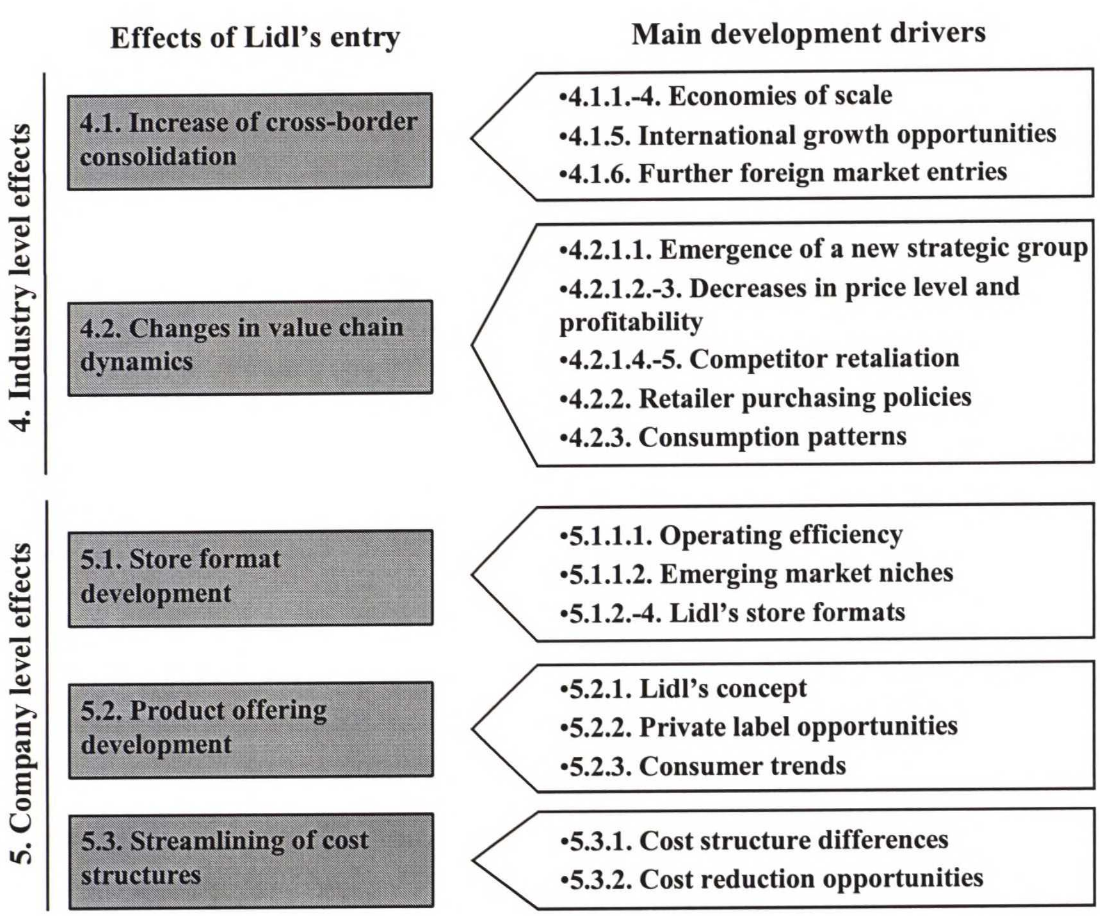
[17] I aim to use year 2000 figures throughout the report, as most of the data concerning the Finnish DCG market is available from year 2000. However, limited availability of data has resulted in using data from various years. Some figures concerning Finnish companies are available also for year 2001, but older figures are used instead because of consistency reasons unless they provide dramatically new information. The exact figures are not relevant for such high level industry analysis, but the development trends and relative power positions these figures will reveal.

3.4. Research structure

I have structured this report around five theses of the market entry's effects, and providing supporting arguments, i.e., describing factors driving the industry development (figure 11). This research will follow a top down structure, starting from analyzing the industry level implications in chapter 4. and moving on to the company level implications in chapter 5. Chapter 4. is divided further into two parts. In section 4.1., I will discuss how Lidl's market entry will affect the level of internationalization in Finnish DCG retailing. Section 4.2. covers how the industry value chain dynamics will change with regards to competition, suppliers, and customers. Chapter 5. covers the implications on a company level. I will assess differentiation in both, store format development (5.1) and product offering (5.2). In section 5.3., I will focus on the cost side, comparing the cost structures of Lidl and the incumbents and assessing how the incumbents could reduce their costs.

Figure 11. Structure of the report



I will discuss the main findings of the research on a foreign entrant's effects on an industry both from empirical and theoretical point of view in chapter 6. I will summarize my evaluation of Lidl's opportunities in the Finnish market, the impacts of market entry on the industry and incumbents, and discuss the main sensitivity factors (6.1). In section 6.2., I will assess how this empirical research reflects on the theoretical framework presented in chapter 2. and suggest generalizations based on the study. I will conclude with suggestions for further research (6.3).

4. INDUSTRY LEVEL EFFECTS

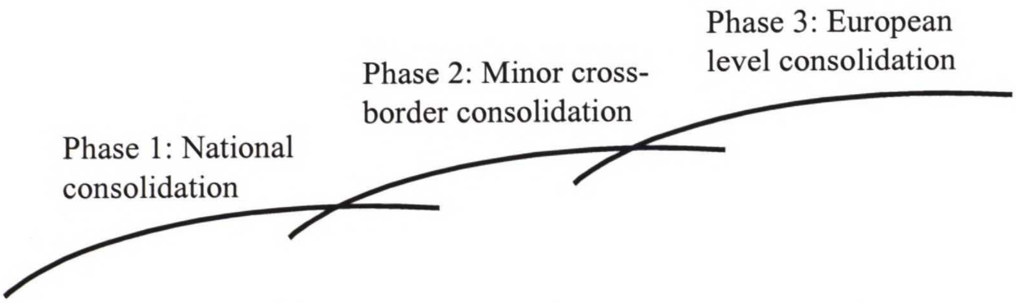
Structural and dynamic changes result in an industry evolution. In this report, I will concentrate in the dynamic evolution, and the structural changes caused by company level actions. Individual or collective actions of companies or other industry constituents drive the dynamic changes. Company level actions are often a response to changes in the external environment, especially competitive landscape. Industry and company level changes are thus intertwined, and must both be assessed in order to understand the causal relations of industry evolution. I will start out by assessing how Lidl's market entry will affect the industry level factors, increasing cross-border consolidation of Finnish daily consumer goods retailing and altering the value chain dynamics.

4.1. Increase of cross-border consolidation

Retailing is becoming increasingly international and consolidated, and major retailers derive significant shares of their revenue from cross-border activities and control larger portions of the market. Consolidation has moved in three phases, from national consolidation to minor cross-border and European level consolidation (figure 12) (Dodgson 1999: 21). The underlying rationale for the consolidation has been increasing market power and reaching cost economies. In some of the interviews, market position was identified as an important factor determining the group's abilities to fare in the intensifying competitive pressure. The incumbent groups might be interested in improving their competitiveness through national consolidation as well as expanding into neighboring areas and seeking international alliances. Cross-border consolidation has been used as defensive strategy against the threat of international entrants, as seen with the merger of French chains Carrefour and Promodés as a counter strike for Wal-Mart's entry into the European market (Gurdijan et al.. 2000: 71).

Lidl's market entry will accelerate the international consolidation trend beyond just having another international retailer in the Finnish market. I will start out by examining the international operations and strategy of Lidl. I will discuss how Lidl's entry will affect other retailers' motives for entering the Finnish market and the established retailers' interest to improve their position abroad. One of the reasons for consolidation is increasing scale economies. I will discuss how the incumbents could reach larger scale through developing international alliances and joint ventures.

Figure 12. Consolidation of European retail sector



Description	•Exploiting national economies of scale	•Consolidating in mature markets •Expanding into immature markets	•European retailers expanding to become leading players on a global scale
Examples	•Auchan acquiring Docks de France •Carrefour acquiring Comptoirs Modernes •Metro acquiring Alkauf and Kreighaum	•Carrefour acquiring Pryca •Ahold acquiring Albert	•Merger of Carrefour and Promodés

Source: Adapted from Dodgson 1999.

4.1.1. Lidl's international operations

Lidl opened its first subsidiary in the beginning of 1970's, and continued to expand within Germany until the end of 1980's. The international expansion started in the beginning of 1990's following the lead of its prime competitor Aldi, which is market leader in German discount sector. (Lidl 2002; UK Competition Commission 1999: 77; Nurminen 2002). The expansion has mainly been organic complemented with some acquisitions. Today Lidl & Schwarz operates over 4000 discount stores and supermarkets throughout Europe. Lidl & Schwartz has established market presence in 12 European countries covering most of the western Europe (see appendix 6). Germany is still Lidl's main market, where it has a 9% market share (Standard & Poors 2001: 9). Ca. half of Lidl's outlets are in Germany, generating 75% of the total revenue

(PricewaterhouseCoopers 2001: 5). The German market has reached a saturated phase characterized by dominance of discounters, intense price competition, and low margins.

Lidl's goal is to expand into all west European countries (Helsingin Sanomat 2000). A.C. Nielsen Europa's (ref. Reuters 12.7.2001) survey suggests, that there is a high potential for discount stores in west European countries with low discounter penetration, such as in Finland. According to Ehrnreich and Ackrill (1998: 68) discounters, like Aldi and Lidl, will continue to expand across Europe, focusing on countries where the discounter format is underdeveloped. In its expansion Lidl has followed Aldi to a number of markets. In fact, most of the interviewees were expecting Aldi to enter the Finnish market instead of Lidl. Once moved into the new markets, Lidl has often been able to grow faster and even surpass Aldi (Reuters 25.6.2001). Aldi is also present in most of the markets where Lidl has outlets making their rivalry truly pan European.

In addition to Finland, Lidl is also opening stores in Sweden as well as planning to enter Norwegian, Estonian, and Latvian market (SVT 2000; Hietanen 2002). Scandinavia can also be seen as a ground for expanding into the Baltic States and Russia (Tuormaa 2001: 15). Lidl has also announced having taken its first steps in Hungary and Poland. Czech (where Lidl & Schwarz is present with Kaufland chain) and Slovakia will follow. (Lidl 2002). There have also been speculations about Lidl entering the US and Danish markets (Reuters 12.6.2001, 16.2.2001). The Danish entry has taken this long because of the strong market presence of Aldi and the difficulties the company encountered while reaching it (Reuters 15.1.1999).

4.1.2. Motives for Lidl's internationalization

McGoldrick and Davies (1995: 23) find several external and internal factors that may explain the trend of increasing internationalization in European retail. The *external factors* include:

1) Saturation of national markets makes increasing market share expensive.

2) Legislation constricts expansion in some countries.

3) Falling transportation costs, improving information systems, and opening of frontiers enable cross-border operations.

4) International niche markets of customers with similar tastes in transcultural goods offer market opportunities.

The *internal factors* include:

1) Companies seek higher rates of growth and profitability.

2) Risks are spread geographically.

3) Companies believe to possess exportable know-how.

4) Companies want to increase power over international suppliers.

If we relate these motives to Lidl's international expansion, we see that the main *external factors* for their expansion are saturated domestic markets and existence of international niche markets. German market is highly saturated and the most competitive in Europe offering limited growth potential. In a number of countries, such as in Finland, discounter penetration is low offering market niches. In close to commodity products such as Lidl's, the national differences with regards to consumer tastes are smaller than in more differentiated products. The *internal factors* are seeking higher growth and profitability, possessing exportable know-how (see section 4.1.2), and desiring to increase power over suppliers. Lidl has leveraged its international operations to achieve growth and to increase its scale and negotiation power towards suppliers, resulting in cost economies.

4.1.3. Scalable store formats enabling Lidl's international expansion

Central to the success of cross-border retailing in addition to retailer's capabilities is format transfer strategy. Format strategy often determines the international retailer's ability to gain a strong competitive position in host countries. (Goldman 2001: 222). Medium-sized store formats have proven very viable for fast market penetration and discounter formats are easier to export than full range supermarkets requiring less local adaptation (Ehrnreich & Ackrill 1998: 68, 56; Interviews).

In its expansion, Lidl uses a standardized, global approach, carrying nearly identical assortments in several countries and uses same means of communication everywhere. The value added in such form of expansion is based on high level of vertical integration and the store layout (Rudolph 2000: 7). One of the interviewees pointed out that Lidl will be able to take its logistics optimization further than the incumbents. Lidl builds its outlets in a standard format and uses transportation services designed for its needs whereas the incumbent chains have large differences in the store layouts and use standard transportation services, thus enabling Lidl to reach cost savings through higher logistical efficiency. (Interview).

Discounters' products consist mostly of private labels, which harmonize product ranges across borders. German discounter Aldi says 70 percent of its largely PL assortment is for sale in all of their stores across Europe. (Gurdijan et al. 2000: 70-73). Also Lidl has its pan European PL brands (Ehrnreich & Ackrill 1998: 70). Lidl's UK stores sell 50-50 international and UK products, but the share of international products is higher in many other markets (UK Competition Commission 1999: 77; Reuters 29.7.2000). Gurdijan et al. (2000: 70-72) noted that economies of scale are harder to reach in cross-border retailing due to low overlap in product ranges. "It is harder for European grocery retailers (compared to American) to realize advantages of scale and scope by operating across different European markets due to more heterogeneous consumer tastes." Danish retailer Dansk (ref. Ehrnreich & Ackrill 1998: 69) estimates that "about a third of the typical grocery assortment consists of products that can be absolutely identical in different European countries".

The driving forces for format transfers are motivation to leverage advantages from global operations and the need to adapt to local conditions (Goldman 2001: 222). We can clearly see that discounters can better leverage operations in multiple countries through their pan-European purchasing and managing more harmonized product lines, but they face the risk of achieving fit between the store format and local conditions, which will be discussed in section 4.2.3.

4.1.4. Opportunities for incumbents to achieve economies of scale

Lidl enjoys a relative cost advantage compared to the incumbents derived partially from its larger purchasing volumes. I will provide an insight on how cross-border consolidation can be seen as a mean to counteract Lidl's competitive advantage.

4.1.4.1. Scale and scope through diversification

The incumbents have increased their market power and cost efficiency through diversification. Nearly all major Finnish retail companies are diversified into various business sectors. The only pure play DCG retailer is Spar, deriving its scale from international operations. The small market size of Finland does not allow for reaching efficient scale through operating solely in the daily consumer goods sector. Internationally diversification is uncommon and focused players control the market (Nurminen 2002). In diversified companies economies of scope are sought through synergies of combining business functions in related fields of business. However, for many companies such as Kesko, DCG sales present the main source of revenue. Arthur Andersen sees, that expanding into related businesses will become a growing trend in order to seek more attractive margins and protect against overcapacity and price deflation in their core areas (Arthur Andersen 2001: 13). It is interesting to see whether the multi-business companies can remain competitive in individual verticals, as focused international competitors, such as Lidl, penetrate the market. One of the interviewees commented that Lidl's entry could increase Wihuri's interest to concentrate on its more profitable business sectors thus leading to structural changes in the industry.

4.1.4.2. Scale economies from purchasing power

One of Lidl's competitive advantages in Finland is its purchasing power (Tuormaa 2001: 15). The company has far greater purchasing volumes Europewide, than the local incumbents. However, Ehrnreich and Ackrill (1998: 63) conclude "Limits to the expansion of pan-European purchasing include logistical costs, which can outweigh buying economies". Local sourcing can often lead to cost savings due to potentially lower local prices, transportation and transaction costs, and import taxes (McGoldrick & Davies 1995: 103). Lidl's preference for pan European sourcing implies that the cost disadvantages are outweighed by savings from centralizing purchasing activities and gaining stronger negotiation power towards suppliers.

For Lidl, the purchasing power advantage will be realized at least in those products that also competitors need to import. Ehrnreich (1998: 97) estimates that in the Nordic countries 50-80% of the grocery supplies are imported. However, one interviewee estimated that only ca. 10% of the groceries are imported in Finland. The share of imported goods is far higher in the industrial food segment where Lidl operates (Leutola 2001: 7), as most of the fresh foods are domestic. Importance of importing is likely to rise, one estimate of long run import share in groceries being 30% (Home 1995: 10). The incumbents can increase their purchasing power through joined purchasing operations. Domestic purchasing alliances between, e.g., Inex and Kesko would be banned by the competitive authorities[18] (Interview). A viable strategy is to develop cross-border

[18] S-ryhmä and Tradeka/ Elanto have a temporary permit for combining their purchases through Inex (Interview).

alliances as discussed in the next section and to cooperate horizontally in other areas both domestically and internationally.

4.1.4.3. Cross-border alliances in purchasing

The entry of Lidl will make international alliances even more important (Marknadplats Norden år 2005 ref. Leino 1999: 25; Interviews). There are three main advantages that Finnish retailers derive from international alliances (Interview). The alliances allow for gaining *lower purchasing prices* through larger volumes. The joined sourcing is best applied in budget level products, in which local tastes and ideal quality are less important than prices (Kauhanen 2000a). In such product groups Lidl has the largest competitive advantage, and cooperation can help the competitors to reduce the gap. International alliances enhance opportunities for *private label development*, which otherwise would be limited due to the small market size of Finland. As PL penetration increases (see section 5.2.2.3.), the importance of international alliances grows. In addition, it would be too costly to *import* certain products from *longer distances*.

The major established groups are already members of European retail alliances, which aim to provide a network for information exchange. Kesko is a member of Associated Marketing Services, SOK and Tradeka of Inter Coop/ NAF Internat, and Spar Finland of Buying Internat Group Spar (McGoldrick & Davies 1995: 136-137; LP International/ IGD Research ref. Verdict 2001: 3). One example of new alliances is Kesko joining the WorldWide Retail Exchanges, an electronic business-to-business market for increasing efficiency of forming industry contacts and information management in companies (Kesko 2000). Haapaniemi (ref. Kauhanen 2000a) admits that Kesko has too small volumes and needs purchasing cooperation. Kesko still has some purchasing cooperation with Swedish ICA, 50% of which is currently owned by Dutch Ahold. Interviewees see that this cooperation is likely to increase in the future. Dodgson (1999 35) finds evolution of pan European centralized purchasing organizations unlikely, but the ventures concentrate on exchanging information and knowledge, like WorldWide Retail Exchanges does. E.g., AMS aims to negotiate basic conditions with a small number of core suppliers, targeting to coordinate ca. 10% of its members' total purchasing volumes (Verdict 2001: 7).

Also other Nordic countries provide evidence of increasing allying. In Sweden, the top four groups belong to pan European buying groups (Ehrnreich & Ackrill 1998: 118). "The decision to create Coop Norden increases our volumes and opens possibilities for better performance through higher efficiency and stronger development for the members in the Nordic co-operatives", said CEO of Coop Norge, Svein E. Skorstad. "Most of the synergies are expected within the areas of purchasing, common business and stores development, rational logistics as well as lower costs for IT investments." The savings are estimated at 4% of total turnover giving the new company economies of scale to fight the supermarket chains in increased competition and to give consumers more advantages. Further evidence is Ahold buying 50% of the Norwegian-Swedish corporate ICA and having plans to create a pan-European purchasing platform. (European Retail Analyst 2001).

4.1.5. Internationalization of incumbents

For established retailers, the strategic importance of developing operations in new markets, such as the Baltic States, increases. With foreign entrants intensifying the domestic competition, the growth needs to be sought from new market areas. Analogically, Asko started its operations in the Baltics and Russia when Ikea entered the Finnish market (Reuters 30.8.1996). The domestic groups are actively expanding their operations in the Baltics (Sahiluoma 2001b). Strong presence in the area could also make the incumbents more attractive candidates for cooperation or mergers and acquisitions with large international retailers, as seen with Scottish & Newcastle's acquisition of Hartwall (Hertsi 2002b).

4.1.6. Assessment of possibility of further market entries into Finland

Here, I will discuss how Lidl's entry affects the interest of other foreign retailers to enter the Finnish market in two dimensions. First, I will discuss potential for a foreign acquisition or greenfield entry and then, a joint venture with the incumbents.

4.1.6.1. Intensifying competitive pressure enabling further market entries

The prevailing cross-border consolidation trend would suggest, that there could be further foreign entries into the Finnish market. So far we have observed sequential entries, e.g., in home appliances during 1999 - 2001 and in hardware in 2000 (see figure 1). Finland's purchasing power is number two in Europe measured by supermarket sales divided by the population (Reuters 16.9.2001). The good purchasing power will help to attract foreign retailers in the Finnish market, a market with small total population, low population density, and long distance from the main European retail markets.

A French professor Marcel Corstjens assured, that it is almost impossible to conquer the Nordic markets without acquisitions (Nurminen 2002). If international competition increases further driving down the industry profitability, smaller Finnish companies desiring to exit the market may see the opportunity to sell their businesses attractive. Kauhanen sees sales of ICA in Sweden and Suomen Spar as indicators that there is potential for foreign companies to find acquisition targets (Kauhanen 2000b). The view is also supported by the interviewees, as many of them believed that there might be structural changes in the industry. The number of competitors might be lower in the future and the international groups can become partial owners of the current companies (Interviews). However, Bell (1999: 24) suggests that neither retailer nor consumer cooperatives are available for purchase. Ownership changes could occur in the Ruokakesko - ICA Ahold axis (Bengtson ref. Mauno 2002; Interview). Lidl's greenfield entry has even proved wrong the common assumptions of foreign retailers entering Finland only through acquisitions (Haapaniemi ref. Leutola 2001; 7), demonstrating that it is also possible to enter Finnish market organically.

4.1.6.2. Opportunities for further entries into hard discounting sector

Burt and Sparks (1995: 115) note, that as one operator pilots a hard discount format in European countries, commonly three or four major players adopt the format over time. Considering the small market size in Finland, the number will likely be lower, but the possibility of development of a further hard discount chain should be discussed. Also retail life-cycle theory supports the assumption of further entries in hard discounting sector by Finnish or foreign retailers, as the sector is in a growth stage. The interviewees doubt that Aldi would be interested to enter the Finnish market as Lidl's market entry increases the entry barriers. Some believe that there is not room for two chains in the hard discount sector. One interviewee believed that there is a chance that Lidl could entice further market entries if the Finnish consumers would prove to be extremely price sensitive[19]. Another interviewee found that there could be room for a Wal-Mart type of large format discounter in the greater Helsinki region and potentially some other regions as well, a view which is supported with the strategic group analysis of the Finnish DCG retail sector (see figure 13). Such entrant could potentially be a foreign retailer.

Incumbent groups might be interested in developing their own discounter formats as seen, e.g., in Italy after the market entry of German discounters. Most of the interviewees estimate the long-term (in ten years) market potential for hard discounting sector to be ca. 10%[20]. The opinions vary slightly in both directions. The interviewees agreed that there is a clear market niche in this sector, which has been proven by a stable position of discounters in durable goods[21] and also the success of foreign entrants with low price strategies in a number of industries. It would seem strange that the incumbent groups would not consider pursuing a 10% market segment while discounting erodes the market shares of other store formats. In Sweden, ICA Ahold is responding to Lidl's entry with Danish Netto discounter concept (Mauno 2002). The leading Finnish groups have already gained first experiences in discounting, S-ryhmä with Sentti, Kesko with Säästumarket in Estonia, and Spar with Axfood's Willy's Hemma in Sweden. The incumbents might convert some of their existing outlets into discounters, but without making large changes in the concepts (Interview). However, the incumbents have no chances of reaching similar efficiencies as Lidl (Interview).

In a concept sense the only counter move would be a copy of Lidl that would be even cheaper and have even larger volumes (Interview). The interviewees found it unlikely that the incumbents would engage in hard discounting in a short run as their infrastructure is designed for different kind of operations and they do not possess adequate know-how thus forming entry/ mobility barriers. If the incumbents would decide to enter hard discounting, they would more likely do it in cooperation with a foreign established discounter to reach sufficient scale, cost economies, and experience in the concept (Interviews). One interviewee found that such combination could outperform Lidl, as the domestic group could provide synergies into the joint venture in, e.g., logistics. In Sweden, ICA Ahold responds to Lidl's challenge with Danish Netto discounter concept (Mauno 2002). Such strategy is not completely new in the Finnish retail market. SOK

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[19] This would support the findings of Seabright (see section 2.5.2) that a foreign entrant could entice further entries as it tests certain unknown market characteristics.

[20] One interviewee commented national hard discounter potential to be dependent on, e.g., how close the other store formats were to the discounters concept wise. This would suggest that if the incumbents would adjust their position strongly towards Lidl's by decreasing costs and adopting low price products, this would reduce the long-term hard discounter market potential.

[21] One interviewee said that "wild" groups such as Veljekset Keskinen and Halpahalli hold a 5-6% market share in durable goods, and the share has remained stable for long.

developed Hot home appliance chain in 2000 as a joint venture with German Brinkmann in order to gain required scale and experience (Sahiluoma 2001).

In comparison with the incumbents, Lidl enjoys a competitive advantage in terms of scale and experience in private label products, which are cornerstones of most hard discounter strategies. Porter (1980: 154) sees economies of scale, experience, and to some extent relationships with PL customers as key barriers protecting PL strategic group. Porter's (1985: 17-18) view on pursuing simultaneously cost leadership and differentiation strategies is fairly discouraging, succeeding requires abilities to strictly separate the units pursuing different generic strategies. Joint ventures would also enable the incumbents to better separate the discounter units from the units pursuing differentiation strategies.

4.2. Changes in value chain dynamics

The Finnish DCG retail sector has long been characterized by stable structures (Dahlbacka 2001: 4) and fairly stable market positions. Lidl's entry will bring new competitive pressure in the industry by introducing a new business model. Here, I will discuss how the competition intensifies and how the competitors will likely react to the market entry. I will also assess the continuing shift of negotiation power away from suppliers, and the role the customers play in the success of Lidl.

4.2.1. Increased competition in retailing

Lidl's market entry increases the industry capacity and its lower price level sets pressures on the competitors to reduce their prices. In benchmark Finnish industries, most of the foreign chains have been able to achieve and maintain growth rates substantially higher than the industry averages, thus decreasing the market shares of the incumbents. Here, I will discuss how the market entry will change the competitive landscape using strategic group analysis.

4.2.1.1. Strategic group analysis of impacts of Lidl's entry

When examining the strategic groups of the DCG retail industry, the appropriate dimensions for strategic group formation could be store size and competitive strategy, i.e., price or quality[22].

[22] I am using attributes such as level of service, shopping comfortability, vicinity to customers, and breadth and nature of product offering to evaluate whether the competitive strategy is based on quality.

Store size reflects resource commitments, location, and the range of products and services offered (Burt & Sparks 1995: 114). The competitive strategy mirrors the customer segments, the types of products offered, as well as the store brand. The dimensions can be seen to reflect both the strategies of the chains as well as the mobility barriers, thus complying both of the views for optimal basis for strategic group formation criteria discussed in section 2.1.1. The examination is more useful to conduct on a chain rather than group level, as the groups are involved in different market segments through their various chains. When going down to store level, geographic reach should also be considered as one axis.

Figure 13. Positioning of retail chains in Finland[23]

New strategic group

Competitive strategy	*Small*		*Large*
Quality	•Pikkolo/ K-Extra •Spar Express •R-Kioski	•Sokos •Stockmann	
	•K-Lähikauppa •Rimi •Alepa/ Sale •Siwa •Rabatti •Tarmo •Ruokavarasto	•KKK-Supermarket •KK-Market •S-Market •Valintatalo •SuperSpar •SparMarket •Sesto •Hansa	•KKKK-Citymarket •Prisma •Euromarket/ Maxi •Eurospar •Sesto Etujätti
Price		•Lidl	

Size

Sources: Annual reports; Company websites; Oksanen 2001; A. C. Nielsen ref. Finnish Food Marketing Association.

[23] I have used the chain descriptions prior to chain reform of Spar and Kesko, as chains from several different groups have been combined in the reform, which would have reduced the accuracy of the categorization.

4.2.1.1.1. Industry level impacts

Dreesman (ref. Brown 1987:8) suggests that emergence of new retail species is sudden, violent, and followed by a long period of incremental development. *Lidl establishes a new strategic group, operating with a medium-sized format providing low-end services.* Lidl's differing business model will reinforce the impacts it has on the whole industry. If compared with Gigantti, which penetrated the Finnish market with similar formats its competitors had and used penetration pricing to gain market share (Bhose 1999: 12-13), Lidl will have a more profound and longer lasting effect on the industry. Grocery stores face the most intense price competition from stores offering the same array of goods in the same trading area (Binnkley & Connor 1998: 276). Even though Lidl is not in the same strategic group with the incumbents, the physical proximity and substitutive nature of its product offering lead to overlapping customer segments and intensify the price competition in the geographic areas where Lidl is present. As mentioned earlier, the level of rivalry between strategic groups is affected the most by the overlaps in target customer segments (Porter 1980: 138-139).

Most of the interviews found that the impacts of Lidl's market entry are local at first. The outlets in the vicinity of Lidl's outlets will lose some of their sales to Lidl. The breadth of the impacts depends on two factors[24]. How wide Lidl spreads its outlet network and how the competitors will react to the competitive pressure. (Interviews). These factors will be discussed later in the report.

4.2.1.1.2. Group and chain level impacts

Some of the interviewees found that the large format stores will be affected the most because of Lidl's more direct impact. Lidl sets its outlets outside city centers in the vicinity of large stores, and sells mostly products, industrial groceries, that consumers buy from larger outlets. Furthermore, one interviewee suggested that Lidl will affect most those chains whose customers appreciate low prices the most. Such chains are large format players Eurospar, Prisma, and Citymarket. (Interviews). However, loss of market share will somewhat be compensated with the ongoing trend of increasing share of large format stores (see section 5.1.1.1.). Lidl could affect very strongly smaller outlets located in the vicinity of Lidl's stores, especially in smaller regions, as Lidl's entry could reduce their sales relatively the most (Interview). According to these

[24] Excluding factors that affect Lidl's success, such as consumer reactions, which will be discussed in section 4.2.3.2.

interviewees, corner stores will not suffer as much as they are positioned for location and are used for fill in purchases mostly for the fresh products, a category where Lidl is weak.

On the contrary, some of interviewees found that corner shops would be the most vulnerable, referring mostly to reasons that are behind the ongoing store format development trend towards large format stores (see section 5.1.1.1.). Lidl's market entry might accelerate this development to some extent as large format stores are most likely to adopt, e.g., low priced product ranges which will increase their relative attractiveness in comparison to smaller format stores. It could be thought that Lidl would affect the least smaller format stores (under 100m^2), which are competing strictly for location and can currently maintain an above industry average price level (see section 5.1.1.2.).

How highly Lidl's physically indirect competitors, e.g., corner shops, will be affected by the entry is dependent on the reactions of the competitors in Lidl's vicinity. If those competitors will improve their value proposition and reduce their prices sharply, the effect is stronger. Then the physically indirect competitors who are unable to keep up with the industry development, especially smaller groups and unchained retailers could end up suffering the most. In Germany, the discounters' success has come at the expense of small retailers and the traditional, mid-sized supermarkets (Fuhrmann ref. Thorne 2000). There the DCG retailing is characterized as highly competitive with price as the overriding attribute (Standard & Poors 2001: 8-9), thus reflecting strong adjustments of all competitors towards discounting concept. In other Finnish industries, the entries of foreign retailers have been estimated to have impacted small and medium-sized retailers the most (Pöysti 2000; Sahiluoma 1998; Bhose 1999; Reuters 28.11.2001, 9.8.2000).

Determining how different groups will fair in the competition is a function of many variants. The impacts can partially be examined through the positioning of the groups' chains, and assessing which chains are likely to lose the most. One of the interviewees highlighted the meaning of current market position suggesting that largest groups have best abilities to fair in the intensifying competition due to their strong market establishment, good industry connections, and solid market position. This would increase the interest of smaller groups to improve their market position through structural arrangements. Other factors that determine group level impacts are group's abilities to improve their position and cost structure. This would require investments, and at least Tradeka, which is currently in reorganization state, could be ill positioned to commit required investments. (Interviews) The chains with the most solid concepts[25] could be better positioned to fair in the competition (Interview). One interviewee suggested that the groups with least loyal customers would suffer the largest impacts. This is further discussed in sections 2.3.2. and 4.2.3.3. A common view is that all players will lose to some extent, both on chain and group level (Interviews; A-Plus 2002).

4.2.1.2. Decrease in price level

Lidl's standalone effect on the price level is not substantial. If the chain captures 5% market share and has 20% lower prices as competitors, the impact on the industry price level is only 1% following a simple calculus. In the banking sector, the research suggests that foreign bank presence, rather than the size of these banks, affects the level of competition and market efficiency (Claessens et al. ref. Hermes & Lensink 2001: 3). Grant (1998: 335) notes that internationalization lowers seller concentration and increases the diversity of competing firms, suggesting higher level of competition. Matti Haaman, the CEO of Inex Partners Oy notes that international companies entering the Finnish market with new business models and extensive resources bring in pressures for the competitors (Inex Partners 2001).

The indirect price reductions have more dramatic impacts on the price level, of which we can see evidence in a number of markets. Corporate Intelligence Group (ref. McGoldrick & Davies 1995: 202) have described that discount companies have had a "destabilizing effect disproportionate to their numbers" in the UK. Lahti (ref. A-Plus 2002) comments that the last remains of closed competition will be abolished with the market entry of Lidl. He adds that the incumbents do have some slack in their prices. In UK, price wars have lead to declining prices and margins for the whole industry (Reuters, e.g., 21.1.2000). Even in Sweden, rapid increase of discount format penetration together with industry concentration have contributed to the intense price competition and lower margins (Ehrnreich & Ackrill 1998: 118-119).

Lidl's market entry will reflect in the price level fast (Interviews; Vanhala ref. A-Plus 2002). In fact, Lidl's entry has already reduced the price level as incumbents have increased their lower priced product ranges. The magnitude of price reductions varies by product segments, and substantial reductions can occur in some categories. The price reductions will be local at first,

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[25] I.e., the level of chaining is high in these concepts and the chains are clearly positioned.

spreading "like a stone thrown into water" and the impacts can clearly be observed nationwide in few years. Competitor overreactions, such as national price declines or introduction of low priced products in outlets not in the vicinity of Lidl's stores, would accelerate the development. As the retailers in the vicinity of Lidl's outlets lower their prices, this creates pressures for their competitors to lower their prices as well. (Interviews). One factor moderating the price level decline is the incumbents' ability to respond with local pricing. Most likely Lidl will adopt a nationwide pricing policy in Finland as they do in UK[26], whereas most incumbents, e.g., K-ryhmä have a local pricing policy (UK Competition Commission 2999: 77; Vanhala ref. A-Plus 2002). The incumbents can react to Lidl's price competition more aggressively locally, while maintaining higher prices and margins in other regions resulting in smaller industry wide price reductions.

4.2.1.3. Decrease in profitability

So far the competition has not been fierce enough to have eroded the industry margins (Interview). "The Nordic market is still dominated by domestic chains and corporates, but this situation will soon come to an end. So will the relative comfort of profit margins; they have been falling in the last few (years), in some cases dramatically." (European Retail Analyst 2001). The incumbents should not aggressively start competing on prices at the expense of profitability (Interview). UK and Germany's markets serve as examples of cannibalizing effects price wars can have on an industry. Gigantti and HOT's market entry caused the home appliance retailers to compete with price discounts in Finland, but the interviewees did not find aggressive price competition the optimal defensive strategy in this case (Interviews; Reuters 23.7.2001).

According to interviews, there are three factors that will drive the development of retail margins downwards as Lidl enters the market. *Increased competition* will set pressures on the retailers to lower their prices as discussed above. As the incumbents increase their capacity by building larger format stores (see section 5.1.1.1.) and Lidl brings further capacity with its greenfield

[26] The interviewees could not provide their insight on whether Lidl would use nationwide pricing. Considering Lidl's low outlet number in Finland and high relative overhead costs this approach would seem rational. Nevertheless, maximizing capabilities to establish a local price leader position could justify local pricing. However, lack of competition in the lowest price segment moderates the need for more aggressive pricing locally.

entry[27], the industry capacity grows faster than the demand. *Industry overcapacity* affects efficiency adversely, deteriorating the profit margins. "Whether the pressures of new entry and excess capacity will cause industry margins to collapse depends on the extent to new supply will create its own demand." (Grant 1998: 67). Unlike with Ikea, Lidl's products are complete substitutes with products of astablished retailers thus creating no additional demand. This might force some competitors to reduce their capacity in the least competitive locations and store formats. Lidl's entry will increase the share of *low priced products* (see section 5.2.2.3.). According to one interviewee, lower priced products tend to have lower monetary profitability, and he believes that this will also be the case now. (Interviews). However, certain developments that Lidl accelerates can moderate the decline of profitability. Such factors are increasing private label penetration and power position shifting away from suppliers (see section 4.2.2.). PL margins are greater for two reasons: retailer bargaining power is greater against wholesaler and they offer protection from retailer-to-retailer competition (EU Competition Commission 1999a: 122).

4.2.1.4. Competitive strategy of Lidl

Lidl pursues a strategy of aggressive face-to-face competition. It commonly seeks outlet locations right next to its competitors' outlets, usually the local price leaders (Tuormaa ref. Kauppalehti 2001a; Vihma 2001: 24), where it tries to win the customers over with its lower price image. One of Lidl's competitive tools is its policy of minimal public reporting, competitors are forced to wait and see which markets Lidl enters next. The company's marketing strategy will be discussed in section 5.3.2.6.

4.2.1.5. Competitor retaliation

UK is the most apparent example of aggressive competitor reactions to Lidl's market entry. The German discounters Aldi and Lidl have been struggling in the market for nearly ten years without being able to reach desired market shares. The key reason for the hardship has been the supermarkets' aggressive retaliation (Reuters 23.7.1999). The local chains have extended their prices and product lines downwards. In 1998, the price difference between supermarkets and hard discounters was 25%, and by fall of 1999 it had narrowed down to 7-30% in a food basket

[27] It should be noted that Lidl does not only increase the capacity in retail, but also in wholesale and logistics.

comparison. The analysts estimated the discount to be only 5-10%. (Reuters 9.10.1999, 23.7.1999). The traditional supermarkets were apparently able to offer an attractive value proposition for the less price sensitive British consumers with only reasonably higher price (Reuters 23.7.1999). Another example of price retaliation is Ireland, where Tesco slashed 20% off the cost of over 50 products and private label prices were cut in many supermarkets as a response to the discounters (Reuters 5.10.2000, 9.9.2000).

The question is, why the British supermarkets were able to retaliate so successfully. The UK retail segment is fairly fragmented, with several medium-sized players, none in a dominating position. This leads to a high level of competition (Porter 1980: 18), which has ensured that companies operate with competitive cost structures. Also Datamonitor's (ref. Dodgson 1999: 36) survey reveals a correlation between industry consolidation and pressure on retailer's margins. The major UK retailers are volume wise fairly large retailers, thus being able to compete with sufficient scale. Only 50% of Lidl's products in the UK market are imported (UK Competition Commission 1999: 77), so the company was unable to take an advantage of its pan European purchasing power in all the products. The British market is the most advanced private label market in Europe with high PL penetration, small relative discounts, and sophisticated PL strategies (Datamonitor ref. Ehrnreich & Ackrill 1998: 27; Ehrnreich & Ackrill 1998: 128). Popularity and premium positioning of private label products has enabled the supermarkets to better differentiate themselves[28].

In comparison to the UK market, I would expect the competitor retaliation to be less aggressive. The Finnish companies are significantly smaller than their British counterparts, and cannot compete with scale without international alliances. The PL penetration and sophistication is also lower in Finland, limiting the extent of having established differentiated positions through PL products. The incumbent groups do not have the financial muscle to suffer losses for extended periods of time, where as Lidl is capable of suffering losses (Interview). As mentioned earlier, the incumbent retaliation mostly shows as an increase of lower priced product ranges and cost position improvements. One interviewee also speculated that the competitors have tried to

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[28] Brown and MacDonalds argue that the UK retailers lack differentiation and proximity is the single most important criterion in determining the choice of shop (Brown and MacDonlads 1994 129). However, newer sources suggest that the British retailers have been able to different themselves, e.g., through their private label offering (e.g., Ehrnreich & Ackrill 1998)

hamper Lidl's opportunities to gain planning approvals[29]. The incumbent retaliation could be significant if one of the competitors would decide to engage in a head on format competition by establishing a hard discounter chain (see section 4.1.6.2.).

4.2.2. Dilution of supplier power

Driven by small market size, Finnish DCG industry is characterized by high consolidation in the downstream activities measured both by Herfindahl-Herschman index (Bell 1999: 20) and absolute market shares. The top five retailers in Finland accounted for nearly 95% of the total sales in 2000 (A.C. Nielsen ref. Finnish Food Marketing Association 2001) while the corresponding figure for west European median was 72% (Bell 2000: 27). On the other hand, the upstream market is highly fragmented. High relative consolidation has shifted the negotiation power towards retailers as discussed earlier. Some of the developments facilitated by Lidl's arrival will further weaken the position of suppliers.

4.2.2.1. Lidl's purchasing policy

Lidl's market entry will reduce the domestic concentration ratio in retailing. However, Lidl's purchasing policies and operations outweigh the advantages of lower concentration for suppliers. Lidl has state of art, skilful buyers. The company combines pan European and local procurement. The country units carry the wholesaler function; they buy goods from other Lidl companies and from local suppliers selling them further to the stores. They also buy certain local products and resell them to Lidl subsidiaries in other countries. (UK Competition Commission 1999: 76-77).

In Ireland, the company has faced opposition from suppliers demanding the company to increase its local supplies (Reuters 17.7.2000). Companies often sell the same private label products also in their foreign subsidiaries (Ehrnreich & Ackrill 1998: 70), and also Lidl will most likely import a larger share of its products than the incumbents. The company's strategy is to procure products only if it can buy them cheap. (Tuormaa 2001: 14; Vihma 2001: 25). Lidl's procurement policy deteriorates the position of suppliers as the competition becomes more international and only cheap products with a lower degree of differentiation are bought. The managers in the Finnish grocery industry have confirmed that they will not grant Lidl preferential prices (Sinervä 2002c).

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[29] In Ikea's case this was seen as a major factor prolonging the company's entry (Interview).

However, Tuormaa (2001: 15) suggests that the company might be able to negotiate lower prices, as the chain offers suppliers a potential for opening up markets for their products in Europe. In furnitures, Ikea has become an important customer for many small manufacturers (Reuters 23.7.1998).

4.2.2.2. Changes in incumbent purchasing policies

Lidl's entry will increase pressures for the competitors to improve their cost structure, e.g., through developing and strengthening their chains (see section 5.3.2.2.). Chaining of the leading retailers leads to centralized purchasing, which further weakens the negotiation position of the suppliers (LTT 1994: 66). This shifts the competitive advantage towards the downstream companies, as the dependence on individual suppliers decreases. Static nature of the industry relationships through ownership arrangements increases the combined negotiation power of wholesale and retail sector.

The share of private label sales will increase in Finland as Lidl prefers PLs and the competitors will develop their PL strategies (see section 5.2.2.3.). PLs will shift the power away from suppliers as the retailer gains a larger control over value chain activities, such as logistics and marketing (Home 1995: 35; Hertsi 2002c). One interviewee sees PL development as one of the main advantages of international alliances. Increasing share of PLs would thus indicate a higher share of imported purchases through international alliances[30]. Cross-border consolidation will result in increasing shares of procurement through international buying groups, both in PL and branded products. This increases the suppliers' risks of losing sales to foreign suppliers as products. Hemilä (ref. STT 2002) sees this as a threat especially to small and medium-sized grocery producers. The changing purchasing policies have already hindered the growth of the domestic suppliers (Hertsi 2002a).

4.2.3. Changes in consumer dynamics

Lidl's market entry will have a positive effect on the consumers, as the industry price level decreases and new products are introduced to the market. Adoption of new shopping patterns is one of the most difficult factors to estimate when determining how well Lidl will succeed in the

[30] It should be noted that private label products substitute more products in those categories, such as industrial groceries, which already have a higher degree of importing.

Finnish market. However, this factor can have a crucial effect on the chain's success (Interviews). Some of the interviewees raised customer adoption as the number one issue determining how well Lidl will fare in Finland.

4.2.3.1. Changes in consumer prices and choices

As discussed in section 4.2.1.2., empirical evidence from benchmark markets suggests that Lidl's market entry will likely result in lower consumer prices. This supports the views of Chen and Aalto-Setälä discussed in section 2.3.3. As a new business model, hard discounting, is introduced to the Finnish market, this will positively affect the degree of choice the consumers have. Lidl's ability to reach more consumers through its cross-border operations allows for increasing the versatility of retailing, that the low population density in Finland has so far limited (Santasalo & Hintsanen 1992: 14). Also the competitors will broaden their product categories in the lower end (Interviews). However, there is a possibility of degree of choice decreasing in some areas, as the intensifying competition might deteriorate the chances for independent retailers to survive the competition.

4.2.3.2. Adaptation of consumption patterns

First, I will analyze examples from other west European markets, where consumer behavior has favored or hindered Lidl's success. Then, I will examine the Finnish consumers' buying behavior and evaluate Lidl's chances of succeeding to sell their value proposition to the Finnish consumers.

4.2.3.2.1. Benchmarks from west European markets

The French market has been the greatest success abroad for Lidl. The company has been able to expand rapidly, gaining number one discounter position in the country with 33% share of the discounter market and 950 outlets (Reuters 15.11.2001, 14.6.2000). The French consumers appreciate the low prices of the German chains, and Aldi is even ranked highest in the customer satisfaction according to a French survey (Reuters 14.11.2001, 10.5.2001). Price sensitive markets with high private label penetration and high private label discounts, such as France and Lidl's home market Germany, seem to be a favorable ground for discounter success.

In Spain, Lidl was forced to change its strategy as its concept failed to satisfy the local customer preferences. The private label penetration is fairly low in the country, the customers were not used to discounter formats and resisted change by being highly loyal to local stores and brands (Ehrnreich & Ackrill 1998: 114, 172). The company reduced its hard discount profile, including a name change and an increase in the product lines. (Reuters 28.9.1999). The Spanish industry consolidation is lower than in western Europe, and the customers are more accustomed to making their purchases in smaller, local stores (EU Competition Commission 1999a: 114; Escudero 2000: 5-6).

4.2.3.2.2. Lidl's challenge

Rudolph (2000: 13) finds three basic patterns in consumer behavior determining the consumers' decisions for store selection. First, choosing store based on confidence in the store. Retailer brand becomes the unique selling proposition that the consumer relies on, not the product's brand. Second, label driven approach. Consumers want products with certain labels, and they choose the store based on shopping convenience and level of services. Third, consumers choose the store based on the best price. Lidl is an unfamiliar store to most of the customers and offers mainly unfamiliar products. *Lidl's challenge is to convert the Finnish customers from making their decisions based on store or product brand to price.*

Finnish consumers appreciate service and availability, and Finnish retailers have the best knowledge of the customers (Lahti ref. A-Plus 2002; Interviews). Even though the consumers in general value service and quality, there are also those who use price as number one criteria (Vanhanen ref. A-Plus; Interviews). Some of the interviewees considered Lidl's price based concept as the chain's biggest problem, suggesting that the Finnish consumers would rather choose the quality and service provided by the incumbents. The interviewees found that being Finnish was not the key issue, but rather the business model. However, Ikea, Gigantti, Hennes & Mauritz, and other recent entrants in the Finnish market prove that the companies have been able to find market niches for their low priced strategy in other industries.

Finnish customers are accustomed to branded products as the country has a relatively low private label penetration, and Lidl must convert its customers into users of their mostly PL products and brands that are unfamiliar to the customers. One of the interviewees even considered Lidl's unfamiliar products as a larger obstacle for its success than the business concept. Another one commented that it only takes time for the customers to get accustomed to and evaluate Lidl's products.

Batra and Sinha's (2000: 89) research suggests, that key customer worry in considering switching from branded to PL products is the degree of uncertainty about the quality of PL product. However, most of the interviewees did not find quality as an issue for Lidl, as groceries in Europe are closely inspected. One of the interviewees considered it rather a question of taste and image than quality. Lidl's money back guarantee might work as an incentive to persuade the customers to try out the quality of Lidl's products. However, compared to the incumbents, Lidl has a disadvantage in knowing the local consumer tastes and matching them with its products. if Lidl needs to adapt its product selection, it would imply sourcing a higher share of products locally. This would also affect adversely the cost advantage Lidl will gain through its internationally larger purchasing volumes (see section 4.1.4.2.).

The incumbents enjoy a process advantage, as they can offer the shoppers a better and more convenient shopping process, one-stop shopping (McGoldrick & Davies 1995: 216). Another challenge is *introducing two-stop shopping as a viable alternative* for current shopping patterns *if compensated with adequate cost savings*. The opinions of the interviewees varied concerning this issue. One thought that two-stop shopping will be difficult to sell to the customers, whereas another did not consider it an issue at all, since the consumption model is also observable currently.

Consumer behavior is becoming increasingly homogenous globally (Rudolph 2000: 9), and we can assume that homogenization will also occur in these attributes. Homogenization would suggest, that Lidl's value proposition would appeal to certain customer segment also in Finland. It is likely that in Finland the customer segment will at first consist of lower social class consumers with limited purchasing power as the case was in Germany (Thorne 2000), thus limiting the market potential of discounters.

To conclude, Uusitalo's and A. C. Nielsen's surveys (see section 2.3.1.) imply that there would be opportunities for discounters, such as Lidl, to win customers over in Finland if they only can convince the customers of the attractiveness of their price-quality ratio and obtain good enough outlet locations. Interviews seem to suggest that even though Finnish consumers are not as price sensitive as in France or Germany, Lidl will not experience as difficult demand side problems as it did in Spain.

4.2.3.3. Customer loyalty

Lidl relies on building customer loyalty through unique private label products visibly linked to the store identity and building a positive customer experience with its price-quality offering. PLs have been used before in Finland for building customer loyalty, but to a smaller extend. PLs are seen to have an increasing importance in branding and creating customer loyalty (Yli-Kovero 2002a). Lidl avoids loyalty card schemes in order to offer lower price for all of its customers at the time of purchasing (Reuters 10.2.2001). Jänkä (2001: 11) comments that the commitment of Finnish chains into their group level, costly loyalty schemes gives Lidl an excellent opportunity to create a non discriminatory pricing policy that enhances the perception of low prices. Rintakoski (2002) finds it unlikely that the competitors will abandon their loyalty programs in order to gain a more competitive cost structure. *Lidl will introduce a new way of building customer loyalty, exclusive through the chain's value proposition instead of branding and loyalty schemes*. This might be difficult for the incumbents to respond to with the traditional methods.

As mentioned earlier, one of the interviewees considered customer loyalty as one of the key elements in determining the strength of Lidl's impact on the group level. If the customers are highly loyal to the incumbents as they were in Spain, this would impede Lidl's ability to attract customers. Rintakoski (2002) finds this scenario unlikely, and does neither consider customer loyalty that important in determining group level success against Lidl. The interviewees were not able to provide their views on how Lidl's entry would affect development of the incumbent loyal customer schemes. Many interviewees emphasized the meaning of developing the overall customer ship, and Rintakoski (2002) suggested that linking other services, such as insurance, to the loyalty cards will be used to enhance the value proposition. He added that strengthening chaining and clarifying brands can be used as defensive strategies to improve customer loyalty. Individual methods of building customer loyalty, such as offering banking services, will also be experienced (Interview). In Sweden, groups have already combined banking services into their loyal customer cards and marketing (Nykänen 2002).

4.3. Summary

Lidl's market entry will drive the Finnish DCG industry more international, increasing the cross-border consolidation. Lidl's competitive advantage is largely based on economies of scale achieved through operating with large volumes in a number of markets and using scalable store formats. The market entry will force the established competitors to strive for scale economies from cross-border operations, both seeking growth in foreign markets and developing international purchasing alliances. The market entry might entice further entrants into Finnish markets mainly through joint ventures in case Finnish incumbents decide to pursue discounter strategies.

The entry will increase competition in the Finnish DCG retailing, resulting in lower price level and margins. The impacts will at first be local, spreading then via competitor responses nationwide. The entry will erode the market shares of all incumbents, but due to more direct competitive positioning, large format stores might end up losing market share to Lidl the most. Lidl's purchasing policy together with the incumbents' changes in their product lines will further weaken the power position of the suppliers. Lidl will be able to win over the most price sensitive customers, but consumer preferences play a crucial role on how high the market potential rises. The largest obstacles in consumer adoption seem to be Lidl's no-frills concept and unfamiliar product offering.

5. COMPANY LEVEL EFFECTS

The changes in competitive environment set pressures on companies to adjust their company level operations. The incumbents should counter Lidl's threat by reinforcing their own strengths and introducing lower priced product ranges as well as improving their cost structures (Interviews). "It's not just about price: it's about the total quality shopping experience" (Reuters 9.2.2001). Lidl's entry will likely not affect the core of basic brands or chains (Interview), but some adjustments can be made to improve their competitiveness. I will discuss how the established retailers can improve their value proposition. Lidl will motivate the competitors to develop their store formats and to differentiate their product offering. Differentiation through customer loyalty schemes is discussed in section 4.2.3.3., and marketing in 5.3.2.6. Another way for Finnish incumbents to offer a more attractive value proposition is to decrease their prices. In section 5.3., I will compare the revenue structures of Lidl and the incumbents as well as assess how the competitors can improve their cost structure.

5.1. Store format development

One interviewee caricatured that even though all chains have their concepts, the consumers do not necessarily recognize these attributes: size is the only dimension, which really matters. Uusitalo's (1998: 174) study supports this view. Most of the respondents categorized all grocery stores into few categories, mostly based on store size and type and range of goods. I will discuss the store format development in the Finnish market and aspects concerning selected store formats. I will conclude with assessing Lidl's store format strategy and the competitors' opportunities to respond to the competitive threat by developing store formats.

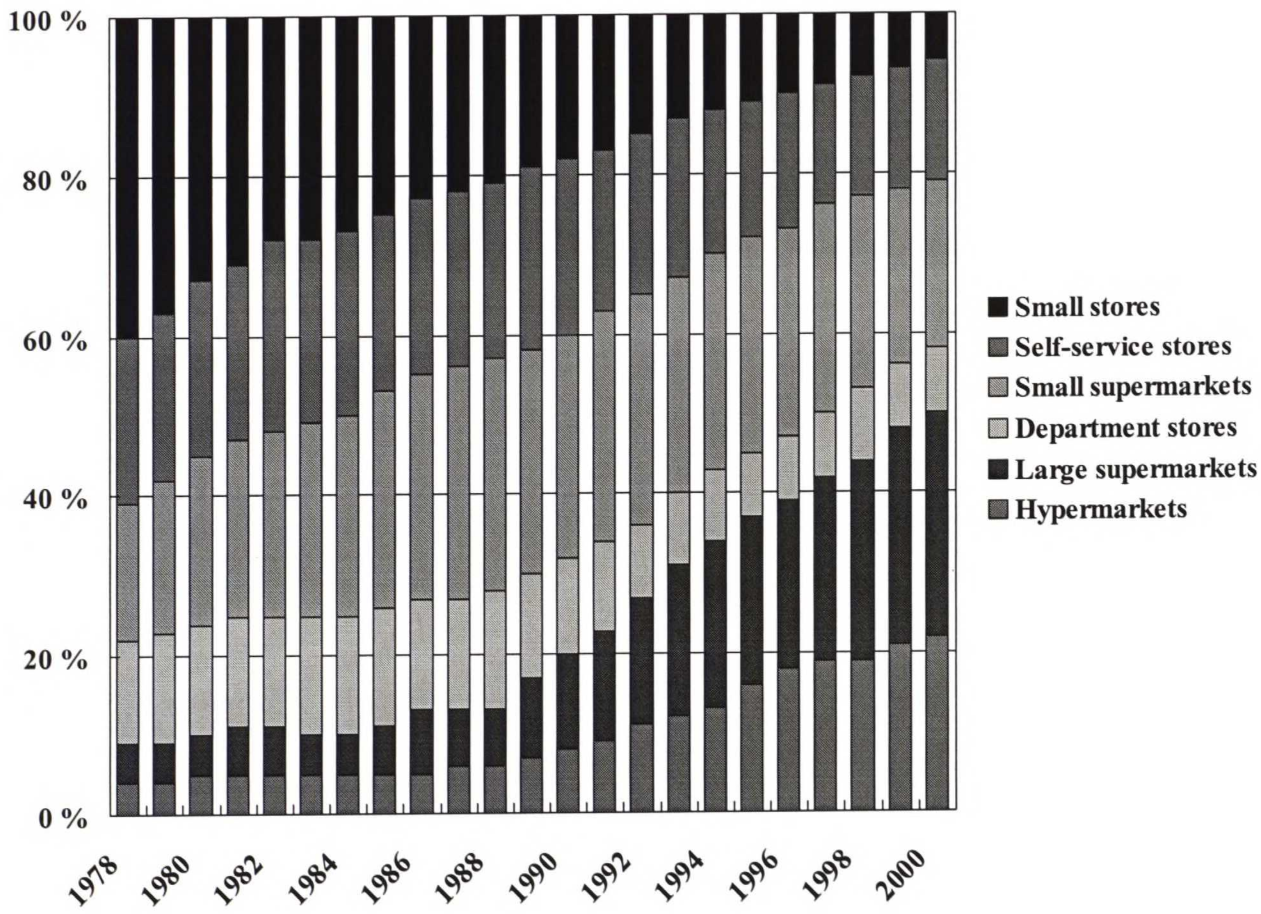
5.1.1. Development trends

Format development changes the competitive scope, and certain retailers compete against retailers they did not compete with in the past (Poplowsky Leszczyc et al. 2000: 323). The development of store format has been strong in Finland during the past decades, increasing the share of large stores of total DCG sales. However, the growth of store size provides market niches for new formats, such as convenience stores.

5.1.1.1. Growth of unit size

The Finnish retailing is increasingly concentrating in large store formats (figure 14). From 1978 to 2000 hypermarkets (>2500m^2) and large supermarkets (>1000m^2) have both increased their share from ca. 5% to over 20% of the total sales at the expense of the small stores (<100m^2), whose share has collapsed from 40% to 5 % (A.C. Nielsen ref. Finnish Food Marketing Association 2001). Hypermarket sales clearly enjoyed an above average growth rate also in 2001 (Finnish Food Marketing Association 2002). The trend of increasing share of large formats seems to continue and the retailers consider that there is still room for new large format stores (Sinervä 2002b; Puhakka ref. Kesko 2001). Large format stores increase industry capacity, but one interviewee found that the overcapacity is not an issue, as the market is in growth. Aalto-Setälä's (1998: 18) research suggests that there are clear economies of scale in retail outlets, which helps to explain the increasing share of large format stores. Expansion and larger store formats are one way to improve market position and efficiency in order to counter the threat of foreign competitors as seen with the market entry of Hennes & Mauritz (Saarinen 1998).

Figure 14. Market share development by store sizes in DCG retailing in Finland, 1978-2000



Source: A. C. Nielsen Finland ref. Finnish Food Marketing Association 2001.

5.1.1.2. Convenience stores

Larger stores neglect certain consumer needs, such as time constraints and need for convenience provided by short distances (Ehrnreich 1998: 137) While making their bulk purchases in large format stores, the importance of local convenience stores for in-fill purchases increases (Arthur Andersen 2001: 8). Small format ($<100m^2$) are not in a direct competition with Lidl, as location is their main competitive tool (Interview). This will likely position convenience stores and other small format stores to fare well against Lidl. The polarization principle implies that there should be a rise of small retailers after the prevailing trend of large format dominance. In Denmark, McGoldrick and Davies (1995: 200) see that discounter Aldi plays a major role in the likely polarization of store formats, where the retailing will take place in large hypermarkets and discounters complemented by smaller, specialist shops.

With increased scale economies, it has become harder for traditional small stores to compete profitably. The retailers need to position the smaller stores better, e.g., as convenience stores, to add value for the consumers and to allow for charging higher premiums (Ehrnreich 1998: 138; Arthur Andersen 2001: 9). This is in line with Grant's (1998) view of using innovation to differentiate in a mature industry. One interviewee found that the convenience stores need to further develop their business model as they will not necessary succeed by offering standard products. The incumbent chains have started developing their convenience store formats, e.g., Kesko has introduced Pikkolo stores with an intention to have 100 Pikkolo outlets by 2003 (Lähteenmäki 2001).

Trompiz (2001) also sees convenience stores operated in conjunction with gas stations, i.e., petrol forecourts, as an important element of food retailer growth strategies. Datamonitor estimates that the distribution share of convenience stores rises from 4.5% to 5.4% and petrol forecourts from 1.5% to 2.7% between 1997 and 2001 in Europe (Ehrnreich 1998: 141). In Finland, the convenience store trend is boosted by legislation, which enables smaller store formats to have longer opening hours enhancing their competitive position. However, prolonged opening hours for stores under 400m^2 have reduced this competitive advantage. Lähteenmäki (2001) notes that many convenience formats have faced difficulties in Finland and he describes convenience markets as growing, but uncertain.

5.1.2. Discounters

Hard discounters have an 8.4% and soft discounters 6.5% share of European food retail sales in 2000. The share of hard discounters has increased substantially since 1995. (A. C. Nielsen ref. Standard & Poors 2001: 9). The Finnish market practically lacks hard discounters and has a limited number of soft discounters. S-ryhmä is piloting a hard discounter Sentti, which can be seen as a defensive strategy against the threat of Lidl. Leutola (2001: 6) categorizes Alepa, Sale, Siwa, Rimi, and Ruokavarasto as soft discounters, even though they do not fit the description of soft discounters presented in section 1.7., but have broader product ranges and compete mainly with their location.

Alepa, e.g., started out with a hard discounter format, but it has extended its product selection and moved into higher margin products, now being practically a corner store (Vihma 2001: 26). This supports the wheel of retailing theory. The trading up of Finnish stores has created a market niche for companies such as Lidl, using a low cost strategy for their market entry. In other market segments, such as hypermarkets, a greenfield entry of foreign retailers is considerably more difficult due to higher market saturation and difficulties in gaining store locations. Ehrnreich and Ackrill (1998: 56) describe, that the price competition is not overwhelming in the Nordic countries apart from Denmark, which partly can be explained by lack of discounters and foreign competition.

5.1.3. Lidl's stores

Lidl's store format is highly simplified with basic shelving, some merchandise sold directly from pallets or cardboard boxes, limited service offering, and only few cashiers (Leutola 2001: 5; Thorne 2000). The stores commonly carry a total of 800-1200 different items, mostly private labels. In addition to DCG products, Lidl also sells durable goods (Lohi 2002). The selection used to consist of only nonperishable products, but the discounters have also expanded into fresh products (Tuormaa 2001: 14). Lidl selects the product range "so that the majority of customers can meet their needs in food and household goods" (UK Competition Commission 1999: 79). Some Italian chains have launched their own discount formats and offer products that discounters fail to supply (Ehrnreich & Ackrill 1998: 102). The simplicity of discounters can be considered both a strength on the cost side and a weakness as it results to a lower level of customer service and a more limited selection. The lower customer service is compensated by considerably cheaper prices, but it gives the competitors an opportunity to fight back with better services. Lidl's no-frills concept can be a major obstacle for the chain in attracting customers (see section 4.2.4.2.).

Lidl sets up its stores in locations with good traffic connections outside the city center in order to minimize real estate costs. In Spain, Lild has established its outlets in suburbs of towns with population over 25 000. In Ireland, the chain tried a different strategy, establishing many stores also in rural area and country towns. (Reuters 20.7.2000, 19.3.2000) The strategy was criticized for leading to distribution problems and a low off-take (Reuters 14.8.1999), and did in fact contribute to the chain's hardship in the country. In Finland, Lidl will set its stores in the whole country (A-Plus 2000), most likely focusing on the vicinity of cities. Some of the interviewees suggested that there might be opportunities for hard discounter concept only in the coastal and central Finland, as the population density is too low elsewhere for such fill in shopping concepts to be successful. If the incumbents engage into hard discounting, they are likely to do so only in selected areas. Lidl might as well try out operating nationwide, and then end up focusing on the most profitable areas. One interviewee concluded that from a competitor's point of view it is a "good and joyful thing" that Lidl will operate nationwide. (Interviews).

5.1.4. Legislative issues

In several markets, Lidl has been successfully able to gain planning permissions very quickly. It seems to be easier to find good locations and to avoid local authorities' resistance with smaller formats. However, Lidl has encountered some resistance at least in UK, Ireland, and Spain. (Reuters, e.g., 5.1.2002). The Spanish 1996 Commerce Law was introduced to make building of new stores more difficult and to protect incumbents, thus increasing the barriers to entry (EU Competition Commission 1999a: 115). This has also slowed down the growth for Lidl, which has been able to increase the number of its outlets only by 10 from 1999 to 2001 (Reuters 9.10.2001; Escudero 2000: 6). Lidl has faced severe problems in Spain reflecting in low market share, slow down of growth, and losses mainly because of differing consumer tastes discussed earlier and the protective legislation. Laws in England also restrict new store openings thus hindering discounter expansion in the country. Italy as well as Poland have proposed similar laws as well. (Thorne 2000). In the British Isles, the local authorities have argued the banning of planning permissions with negative effects on local development in several cases (Reuters, e.g., 7.12.2000).

Most of the interviewees find that Lidl will likely not encounter problems with gaining locations for its outlets in Finland. The decision-making concerning planning approvals is delegated to the communities[31], most of them having a positive attitude towards increasing competition and thus the new entrant (Interview; Vihma 2002a). However, the first comer advantage in retailing shows mostly as an ability to secure the best store locations (Standard & Poors 2001: 6). The incumbents thus often have a competitive advantage in store locations, e.g., in greater Helsinki

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[31] For larger format stores, additional procedures are required involving other parties (Interview).

area Lidl has been forced to settle for secondary locations (Malin 2001: 6). One of the interviewees did suggest that finding store locations could be the largest entry barrier for Lidl.

5.1.5. Store format development as defensive strategy

Dodgson (1999: 28) sees store format diversification a potentially profitable way to increase market penetration in saturated markets. The new shopping patterns that Lidl introduces in Finland might open up growth opportunities in certain store formats, such as convenience stores as discussed earlier. In order to compensate for the decline of market share in other formats, incumbents can reinforce their market position in the growth segments. Competing in alternative retail forms offers possibilities for price discrimination, as different types of consumers may prefer different forms (Binkley & Connor 1998: 277). Developing own discounter formats is one defensive strategy to hamper Lidl from capturing market shares and benefit from the growth opportunities offered by the segment (see section 4.1.6.2.).

5.2. Product offering development

Product offering is strongly interlinked with the store format. Similar store formats tend to offer similar product ranges, but there are also opportunities for differentiating through product offering especially between formats. Here I will focus on the role of private label products, but also discuss shortly differentiation through product selection.

5.2.1. Selection

Lidl's concept focuses on providing a narrow range of mainly industrial groceries while the incumbents provide broader selections with a heavy focus on fresh products. One interviewee estimated that fresh products represent a 50-60% share of the incumbent sales, supported by Jänkä's (2001: 11) estimate. The interviewees found the breadth of selection as one of the strengths of the incumbents. Non-food sales account for ca. 30% of Lidl's sales (Interview), whereas the share varies for the incumbents. Emphasizing the product segments that Lidl does not provide could help to increase the attractiveness of incumbents.

5.2.2. Private labels

Private label development in Finland lags the European benchmarks. I will assess Lidl's PL strategy as well as the PL trends in Finland in terms of penetration and positioning. Lidl's market entry will accelerate the development of incumbent PL strategy and increasing interest in PL products is an indication of defensive strategies against Lidl.

5.2.2.1. Role of private label products in Lidl's selection

Strong private labels have enabled Lidl to build its success. Estimates of share of PLs in Lidl's selection vary from two thirds to 90% of its product range (Tuormaa 2001: 14; Reuters 29.7.2000; UK Competition Commission 1999: 77). Lidl uses the branded products to provide a point of price comparison for the consumers and to emphasize the low prices of its PLs. Lidl has registered several own brands, but the package always carries the name Lidl (UK Competition Commission 1999: 77). Discounters commonly favor PLS, as the companies seek to increase their negotiation power towards suppliers, decrease product costs while ensuring good quality, and avoid from advertising individual products.

5.2.2.2. Private labels in Finland

Private label market in Europe is in growth. Ehrnreich (1998: 4) estimates that PL penetration will increase from 22% in 1997 to 30% in 2002. The Finnish PL sales were only 8% of the total sales in 1997 (Ehrnreich & Ackrill 1998: 18). The current figure is ca. 11% (Bell 1999: 21; Interview). Also other Scandinavian countries, Norway and Sweden, lag just as far behind (Ehrnreich 1998: 79). The growth rate is estimated to be highest in the underdeveloped private label markets, such Nordic countries excluding Denmark. According to Ehrnreich (1998: 97), many Nordic retailers are planning on expanding their PL ranges. In Sweden, the penetration is estimated to rise from 8% to 20% between 1997 and 2002. In Finland, the private labels were expected to generate over 16% of the sales in 2002 and ca. 20% in a longer run. (Tuuri 2002; Datamonitor ref. Ehrnreich & Ackrill 1998: 18, 166-167; Haaman ref. Yli-Kovero 2002c). Spanish example shows, that rapid development of hypermarket concept and foreign retailers, mainly German discounters, boost the PL growth (Ehrnreich 1998: 9)

PLs in the Finnish market mostly sell at prices below branded products, with an average price discount of 15-20% compared to branded goods. The average European discount rate of PLs varies by country between 10%-25%. In more developed PL markets, such as UK and Switzerland, PLs are positioned for quality resulting in far smaller average discount with some products even carrying a price premium. (Datamonitor ref. Ehrnreich & Ackrill 1998: 20;

Datamonitor ref. Ehrnreich 1998: 80). Less than 3% of Finnish PLs were premium ranges in 1997 compared to European average of 7% (Ehrnreich 1998: 89; Ehrnreich & Ackrill 1998: 54). The general trend in PL strategy is shifting from price reduction to raising quality closer to main brands. Reducing prices has fallen from number one position in 1993-1997 to number six in 1998-2002 as the retailers' most used PL strategies in a survey conducted by Datamonitor (ref. Ehrnreich & Ackrill 1998: 162).

5.2.2.3. Effects of Lidl's market entry on private label development

Private labels can be seen as defensive strategies in several benchmark markets. In France, Spain, and Italy, supermarket chains such as French market leader Carrefour and Coop Italia are expected to launch more premium PL ranges (Ehrnreich & Ackrill 1998: 30). This may be explained through the generic industry trend, but it also offers the companies better opportunities to differentiate themselves and increase margins in price competition intensified by the foreign discounters (Ehrnreich & Ackrill 1998: 102). In Belgium, however, the leading supermarket chains have mainly used discount PL products to improve their abilities to compete on price with Aldi (Bell 2000: 29).

The low penetration rate and discount positioning of PL brands combined with general European PL growth trend would suggest that there are opportunities for retailers to pursue market share and profitability growth as well as differentiation through PLs also in Finland. Lidl's market entry will bring the chain's PLs to the Finnish market and will encourage the competitors to develop their PL strategies. Lidl's PLs carry a heavy discount. This offers the competitors an opportunity to choose their PL strategy from a combination of price reduction through low cost PLs and differentiation through premium PLs.

The interviewees commonly found that the *incumbents will raise the penetration of PLs*. The incumbents will adopt at least *two types of PLs: standard and hard discount product lines* (Interviews). However, in discussions with professor Home, he expressed skepticism towards the effect of Lidl's entry on PL development, as the penetration rate has been expected to rise for long without substantial development realized. The competitor reactions, such as introduction of Hyvä Ostos discount PL lines, imply that PL penetration will rise to some extent, but it remains to be seen whether it will reach the estimates presented in the previous section. Yli-Kovero (2002d) emphasizes the increasingly important role of PLs in creating a brand. However, one interviewee noted that even though groups aim at differentiating themselves through PLs, the consumers do not mostly even know which products are PLs and which branded. Kolkman's (2000: 4) study suggests that two fifths of consumers can differentiate supermarket chains by PL product attributes. By offering corresponding, low priced products, the competitors can offer a more attractive alternative for those customers who are the most price sensitive. The competitors seem fairly reluctant to increase the share of low priced products as they erode the sales of their higher priced products. The incumbents will not develop as wide product lines as Lidl in the low price range: "as few as possible, but adequately". (Interviews). Current development suggests that there will not be large group level differences in PL strategies (Interview).

At first, Lidl will have a competitive advantage from its PL products, but in two-three years the competitors will also have their categories in hard discount price range (Interview). Even though the competitors could match the price level of Lidl in their hard discounting product lines, they will most likely not be able to match the consumers' low price image of Lidl, as the chain focuses exclusively on providing low priced products with all discounts granted at the time of purchase. This is a vital aspect, as consumers are not well equipped to estimate small changes in price level (Home 1995: 15-16).

Examples of European players following the UK model of premium PL positioning have realized the profit and market share gains and also differentiated their market position (Dodgson 1999: 101). E.g., in Sweden, the margin squeeze contributed by increasing discounter penetration has made the premium PLs providing higher and more stable margins more attractive, and the price discount of PLs is estimated to decrease from 10% to 5-10% in 2002. (Ehrnreich & Ackrill 1998: 6, 57, 118-119, 161, 167; Home 1995: 35). A. C. Nielsen Finland (2001) suggests that the general trend in the Finnish DCG products is towards premium products. However, the interviewees consider premium PLs to have limited opportunities in Finland. According to one interviewee, the share of niche products is small in Finland due to the small market size, but there might be demand for certain products in the greater Helsinki region.

5.2.3. Consumer trends

Even though the overall industry growth is slow[32], growth rates of different product categories vary. The potential of each retailer to capture the growth from each product category partly determines, how the companies can benefit from the industry growth. The main trends in the European food product development are health, convenience, variety, and individuality serving the needs placed by changes in lifestyles of consumers (Ehrnreich 1998: 2). The convenience (Varjonen Ref. A.C. Nielsen Finland 2001) and health (A.C. Nielsen Finland 2001) trends are growing in Finland as well, and growth can be assumed also for other categories. In Finnish retail, potential new categories generating growth are wine and medicine[33].

Many of the growing product groups allow for charging a higher premium for the products as they contain a higher degree of processing. Retailers might thus be able to gain market share and profitability through increasing their involvement in the high growth and margin segments. The incumbents are better positioned to take an advantage of the growth in the product categories, as Lidl focuses on lower margin, commodity like products and Lidl's larger, internationally interlinked volumes likely make responding to consumer trends more rigid.

5.3. Streamlining of cost structures

Price is one of the main means of competition in retailing (Interviews; Ehrnreich 1998: 142). As results of concentration and fierce competition, opportunities for retailers to raise prices are limited. Thus retailers are now pursuing an alternative strategy to enhance profits, reducing the costs of their supplies. (McGoldrick & Davies 1995: 101). "Sales and distribution costs will also greatly affect individual success." (Ehrnreich 1998: 142) In this section, I will compare the cost structures of Lidl and incumbents and examine how the competitors can lower their costs in order to better cope with the increasing price competition.

[32] The industry growth rate is estimated to be 3-5% in 2002 (Jouslehto 2002b)

[33] This would require a change in legislation, since their retail is currently regulated to distribution channels other than DCG stores.

5.3.1. Cost structures of Lidl and incumbents

Variety in retail margins and prices across retail firms can arise from differential efficiency, variability in the level and composition of retail services as well as variations in the market power of individual retailers (Brunila 1992: 3). Lidl's success is based on a low cost structure. I will examine the revenue structure of Lidl and compare it with the incumbent's cost structure. I will assess the cost drivers and identify areas where the competitors can improve their cost position.

5.3.1.1. Cost efficiency in Lidl's operations

Lidl's business model results in low operating expenses. I have earlier discussed the cost advantages derived from larger purchasing power, standardized store formats, private label products, limited service offering, savings from lack of loyalty schemes, and lower real estate costs. Lower marketing costs will be discussed in section 5.3.2.6. Lidl provides a classic example of a strategy pursuing cost advantage. Lidl has successfully leveraged all main cost drivers in a mature industry - economies of scale, low-cost inputs, and low overheads (Grant 1998: 297-298) – for building its cost advantage.

In order to maximize synergies while maintaining local flexibility, the group has centralized many of its activities while being administratively divided into independent area units. Lidl & Schwarz Stiftung is responsible for the group level cash and carry wholesale, procurement, billing and invoicing systems, IT systems, logistics, and real estate. The stores do not submit orders, but the fillments are conducted automatically according to sales data. Product range focusing on high turnover products allows for faster inventory turnover and thus lower inventory costs. The company owns more than 60 % of the sales space it operates. (Tuormaa 2001: 14; Vihma 2001: 26). The country units manage and own the stores and other property through a separate subsidiary. Regional level managers control some advertising expenditure. National pricing is used (at least in UK) in order to avoid the costs of local pricing and the product selection is also decided on a national level (UK Competition Commission 1999).

5.3.1.2. Revenue breakdowns of Lidl and incumbents

The media estimates that Lidl will be able to offer its products for 15-20% lower prices than the incumbents (A-Plus 2002). The interviewees consider the price differences to be ca. 10%. It should be considered that these differences are not mathematical price differences, but only differences in *price image*, which is a psychological concept formed by the consumers. The products and selections are not identical, and thus cannot be directly compared. Forming differences in price image is what Lidl's marketing aims at. (Interview).

In order to avoid cannibalization of industry profits such as in Germany and UK, the incumbents should not engage in an aggressive price war, but rather seek opportunities for offering more competitive prices by reducing costs. To assess the competitors' opportunities for cost reduction, I will compare the revenue structures of Lidl and the incumbents.

The revenue breakdown has been constructed in the first interview, and the same structure has been used in the subsequent interviews (see appendix 7 for component definitions). The revenue breakdowns have been constructed qualitatively in all and quantitatively in three interviews[34]. A scaled consensus estimates based on the three interviews are depicted in figure 15[35]. The other two interviewees conveyed the same message as the consensus estimate: *Lidl offers a significantly lower price image, the largest differences deriving from product and personnel costs*. The quantitative estimates behind the consensus estimate vary to some extent, but what is actually relevant to the big picture, is where the revenue structures differ and how significantly. In this aspect, the interviewees were fairly unanimous, thus increasing the validity of the analysis. The major discrepancies between interviews were found in product costs, overhead costs, and EBIT. These differences will be discussed later.

The incumbent cost structure is an industry level aggregation. There are several reasons why this approach does not provide an exact point of comparison. There are large differences between cost structures and price levels of different chains (Interviews). One interviewee suggested that the best way would be to select the closest competitor and conduct the comparison with that. The composition of sales differs and has a significant effect on the costs, as Lidl sells mostly industrial groceries goods, has ca. 30% of its sales non food products, and practically no fresh food sales while fresh food sales are central for incumbents (Interview). However, I will use this

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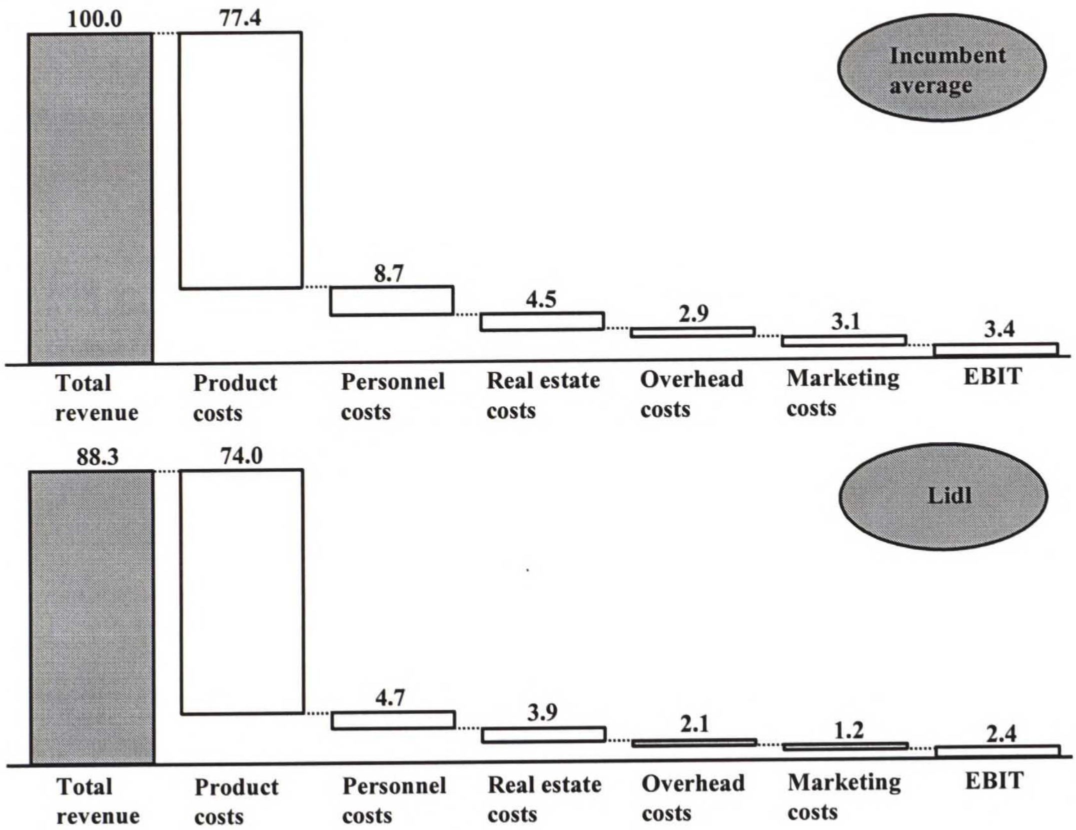
[34] I intended to construct revenue breakdowns quantitatively in all interviews, but due to time constraints in one interview and interviewee preference in another, we discussed the matter only qualitatively in those two interviews.

[35] The incumbent revenue structure has been crosschecked against Santasalo & Hintsanen's (1992: 29-30) research and HOK's income statement (Helsingin Osuuskauppa HOK 2001: 8). The consensus estimate seems to be roughly in line with these benchmarks.

approach in order to gain a high level understanding, in what range the differences are and in which categories, and whether the gaps be bridged. This should only be treated as a *rough generalization*, and if using these figures for practical purposes, deaveraging and including contextual factors should be considered.

Figure 15. Consensus estimates of revenue structures of incumbents and Lidl



Source: Interviews.

5.3.2. Factors behind cost differences and opportunities for cost reductions

The established retailers seem to have a cost disadvantage in several areas. The largest discrepancies between revenue structures were found in the areas of product[36], personnel, and marketing costs. The main cost reduction opportunities lie in product costs. The incumbents will aim to streamline their operations throughout the value chain, develop their lower priced product

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[36] Product costs have been aggregated in the consensus estimate, as it is difficult to distinguish logistic costs from product price. When assessing cost saving opportunities, the purchasing prices and logistics costs through out the value chain will be discussed separately.

lines, and strive for scale economies. Most of the interviewees found that substantial opportunities for cost reductions exist if the incumbents would adjust their concepts towards Lidl's, e.g., by lowering the level of services and offering lower priced products. However, the opinions varied on whether this is a rational strategy and on which dimensions the adjustments should be made. Pressure to reduce costs might also encourage incumbents to seek structural solutions as discussed earlier. In the following, I will discuss the factors causing revenue structure differences and evaluate opportunities for incumbents to reduce their costs in each category.

5.3.2.1. Purchasing prices

The views of all interviewees except one were congruent that Lidl will have lower product costs[37]. This view has moderated considerably the product cost difference in the consensus estimate (excluding that, the difference would have been 5.3 instead of current 3.4). The reasons behind the cost difference have been discussed through out this paper: Lidl has larger purchasing volumes, lower priced, mainly private label products, and efficient purchasing policy. The differences in the purchasing prices vary by products and the largest differences are found in the product categories where Lidl can leverage its Europe wide purchasing volumes (Interview). The incumbents can narrow down this gap by introducing lower priced products (PL and branded), further developing international purchasing alliances, and increasing negotiation power towards suppliers. PLs enable the retailers to compete on price without reducing the gross margins. According to one interviewee, 20-40% cost saving opportunities are possible through international alliances on discounter products. For incumbents, those products account only for a fraction of the total product costs, and the total cost saving opportunities could be 2-3% (Interview).

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[37] I considered the differing view as a defense mechanism. The interviewee tried to convince that the only cost differences were derived from sales margins. The incumbents' higher cost structure is only a result of different concepts, being in fact an advantage, and thus the incumbents would not need to change their operations because of Lidl. The view reflected that particular interviewees' reluctant attitude to admit that Lidl was by any means a threat to their operations.

5.3.2.2. Logistics costs

The interviewees did not consider logistics as a major source of cost advantage for Lidl. The company has advantages from its standardized concept (see section 4.1.3) and centralized activities. However, at first Lidl might even need to operate on higher logistics costs before it has reached sufficient scale (Interview). Rudolph (2000: 19) emphasizes discounters' need to grow fast in newly entered markets in order to reap full benefits of financial planning and economies of scale in distribution. One of the interviewees suggested that Lidl needs to operate over 100 outlets before reaching cost efficient volumes.

The common view among the interviewees is, that incumbents have fairly efficient logistics, but opportunities for improvement remain in some areas. The opinions varied whether substantial cost savings could be achieved in logistics, being mostly biased towards lower significance. Vanhala (ref. A-Plus 2002) finds that the stores that have not organized their functions, e.g., logistics, efficiently enough will lose as Lidl penetrates the Finnish market. One of the interviewees found that the main shortcomings of Finnish retailers in comparison to large international retailers are vertical processes such as product processes, steering processes, and information flows. This means that even though processes within individual companies are efficient, the activities have not been sufficiently coordinated and integrated between different participants, thus leading to sub-optimal industry value chain efficiency. Similar differences were observable when Swedish clothing retailers entered the Finnish market. Thus the entry of Lidl could provide a learning opportunity for the incumbents. (Interview).

The main opportunities for increasing value chain efficiency are in supply chain management and strengthening chaining. *Supply chain management* is central for reaching cost savings, and the incumbents have been working in that area for the past years (Interview; Wires ref. Tupamäki 2001: 9). ECR implementation has not progressed far in Finland due to consolidated market. Incumbents have not been forced to commit the required investments and foreign competition could enliven the development. (Interview). Implementation of ECR includes several obstacles. The required investments are substantial, ECR requires increasingly open information flows between former rivals, and the implementation takes a lot of work, e.g., in making information systems compatible (Home 1998: 74-75). Private labels enhance the opportunities to leverage CM as PL manufacturers are more willing to share information with the retailer (Ehrnreich 1998:

95). Vice versa, supply chain integration is seen to enhance the opportunities to develop PL products (Bell 2000: 29). Improvements in the supply chain could increase the logistics efficiency and shorten the turnover times, thus releasing capital and improving profits (Interview).

Chaining has substantial impacts on the efficiency (Interview). Incumbent sales groups continue strong chaining (Inex Partners 2001), e.g., Spar reduced the number of its chains from five to two in the beginning of 2001, and Kesko announced to reduce the number of its chains by two, to five chains (Spar 2002a: 4; Kesko 2002b). In Finland the groups currently have "chain-like" operations, and strengthening chaining could improve logistics efficiency (Interview). As mentioned earlier, the solidity of concepts, i.e., strength of chaining could be one attribute affecting the chain level success in the intensifying competitive pressure.

In addition to purchasing (see section 4.1.4.3.), savings could be derived through *cooperating horizontally* also in other areas. The incumbents seem to be willing to develop such cooperation (Interview). It seems likely that SOK and Tradeka, which have cooperated in procurement through Inex Partners, will deepen their cooperation in joined business projects[38] (Neilimo ref. Kauppalehti 2002: Vihma 2002b: 8). Currently, e.g., Inex and Tuko share a freezer warehouse company. Combined shippings could be one form of increasing logistics efficiency (Interview). Horizontal cooperation could lead to outsourcing certain activities to third parties. One interviewee found that horizontal cooperation will not offer large cost savings, perhaps only in durable goods.

5.3.2.3. Personnel costs

Personnel costs are a major source of cost advantage for Lidl. The differences are largely explained by differences in store concepts. The incumbents mostly provide a high level of service, requiring more staff, where as Lidl competes with simplified concepts offering very limited services. E.g., shelving and service counters are areas where incumbents need more personnel. (Interviews). One of the interviewees suggested that Lidl's employees have a lower level of professional skills. The opinions varied whether personnel would be the area where cost should be cut. One of the interviewees found that cuts were necessary, while another considered

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[38] There have even been speculations concerning SOK's acquisition of Tradeka (Sinervä 2002a).

this as an area of differentiation where cuts were not needed. Personnel cuts would be a fast procedure to improve profitability (Interview). Reducing costs through personnel cuts seems to be a strategic choice, whether the incumbents choose to compete with higher service level or reduce their prices closer to Lidl's level. One of the interviewees suggested that the incumbents should wait and see whether it is a direction where the competitors want to go.

5.3.2.4. Real estate costs

Lidl will probably not achieve a large cost advantage in real estate expenses in Finland. In countries such as Germany the differences are substantial (Reuters 18.9.2001), but here Lidl needs to build new premises and buy new equipment, thus leading to higher costs. The incumbents' costs might be slightly higher as their outlets are generally better located and the real estates are different type. (Interviews).

5.3.2.5. Overhead costs

The interviewees could not make solid judgments about the overhead costs of Lidl, as many of them were uncertain about the business model it will use in Finland. Lidl's centralized activities would suggest lower overhead costs, but the small scale of its operations will increase the relative overhead costs of running a national organization. One interviewee considered Lidl to have overhead costs half the incumbent average, while others did not see large differences. None of the interviewees mentioned overhead costs as a major area of cost reductions. (Interviews). Structural arrangements and increasing cooperation could naturally bring down the overhead costs, but the savings in overhead would not be the main motives for pursuing such actions.

5.3.2.6. Marketing costs

All interviewees agreed that Lidl would reach substantially lower marketing costs due to its low cost marketing policy. The chain's only marketing instrument is a leaflet distributed at its stores (A-Plus 2002). In case of a market entry, the company enjoys a great deal of free media publicity, as already seen in Finland. However, with intense price competition Lidl has resulted in heavy advertising in some markets, such as Germany, UK, and France (Reuters, e.g., 26.2.1999). Lidl will also save costs by avoiding loyalty schemes. One of the interviewees suggested that there would be opportunities to increase efficiency in marketing. Advertising played an important role in the evolution of UK car industry after foreign market entries in late 1960's (Geroski & Murfin

1991: 799-803), but Lidl's will likely not significantly affect the advertising of incumbents, as the incumbents should focus on strengthening their own brands (Interviews).

5.3.2.7. Profitability

Market entries carry great risks as seen from the varying success of Lidl's international operations and the parent company Lidl Stiftung & Co KG reimburses any losses incurred (UK Competition Commission 1999: 77). When entering a new market, Lidl is prepared to suffer losses for 5-6 years (Vihma 2001: 26). Management Ventures Inc., a global retail analyst company, estimates it usually takes only a year for discounter stores to become profitable (Management Ventures Inc. 2000: 36). In case of a greenfield entry such as Lidl's the initial investments are larger and the breakeven time is longer. The interviewees found it hard to estimate how long it takes Lidl to breakeven, one estimate being 3-4 years. Reaching sufficient volumes is seen important for becoming profitable (Interviews). One interviewee raised a question if it even matters for a large chain whether the EBIT will be slightly positive or negative, if Finland has a strategic role in expanding east bound. In other industries, Gigantti was expected to break even in three years and Hennes & Mauritz in one year (Reuters 3.11.1997, 23.1.2002; Claramunt 2001).

In a long run, all interviewees except one considered Lidl to have lower margins than the incumbents on average due to its low price business model. Hard discounters such as Lidl seem to have lower margins also in other markets. The consensus estimate of 2.4% EBIT seems to be in line with benchmark observations (Reuters 15.9.2001, 4.10.2000). The competition in Finnish market has not been so intense that it would have eroded the margins (Interview). Lidl's entry will most likely affect the industry profitability adversely (see section 4.2.1.3.). The interviewees considered that the established retailers should rather focus on cost reductions than sacrifice margins when responding to Lidl's price competition. The opportunities for cost reductions have been discussed above.

5.4. Summary

Emergence of a new strategic group having substantial overlaps with existing groups' customer segments increases the competitive pressure and forces the incumbents to make changes in their operations. Store format development offers opportunities to strengthen market share in growth sections, such as large store formats and convenience stores. Differentiation in DCG retailing is difficult within similar store formats. Differentiation can be pursued through, e.g., product selection and private label offering. The groups and chains accelerate their private label development aiming not only to increase differentiation, but also to reduce the relative attractiveness of the new group by offering lower priced alternatives for the most price sensitive customers. The competitors attempt to narrow down Lidl's cost advantage by improving their cost structure focusing on purchasing and logistics costs. The company level changes facilitate the industry level evolution. Reducing purchasing costs through international alliances increases cross-border consolidation and the cost reductions together with lower priced product ranges lower the industry price level.

6. RESULTS

The different dimensions discussed throughout this report intertwine. I will combine these effects shortly, summarizing how Lidl will affect the DCG industry. Examining the impacts allows me to assess the theoretical framework in light of the empirical evidence. To conclude, I will suggest some areas for further research.

6.1. Effects of Lidl's market entry on Finnish daily consumer goods industry

In this section, I will shortly summarize my evaluation of Lidl's opportunities in the Finnish market as well as the effects of market entry on incumbents and the overall industry development as discussed in chapters 4.-5. I will complement these summaries with an assessment of the main sensitivity factors.

6.1.1. Lidl's opportunities in Finnish market

Lidl will succeed in establishing a solid position in the Finnish market, most likely capturing at least a 3% market share within the next three years. The company will manage to create demand for its low-end value proposition, persuade the most price sensitive consumers to adopt a two-stop shopping pattern and to try out its private label products. Lidl's success will be based on its cost advantages deriving from scale economies and low cost business model.

The main factors affecting the degree of Lidl's success are customer behavior and competitor reactions. Some benchmark markets have proven that customers might be unwilling to switch their shopping patterns thus significantly impeding the success of hard discounters. The incumbents are unable to engage into full-fledged competition in hard discounting on their own. Other foreign entrants could seriously intensify competition in the hard discounting sector, either on their own or in cooperation with the incumbents. Also the willingness of incumbents to adjust their concepts towards Lidl's by lowering their prices and introducing low priced product ranges could reduce the customer's incentives to switch for shopping at Lidl's.

6.1.2. Impacts on industry

Lidl's market entry will accelerate the industry development through direct and indirect effects. The industry development will be in line with the existing market trends. The strategic importance of cross-border alliances and operations will continue to increase as well as the convergence of Finnish and western European daily consumer goods industries. An emergence of a new strategic group will intensify the competition and accelerate the industry development. This will lower the industry price level and affect profitability adversely. Lidl's entry will boost the private label development both, in standard and hard discount categories. Store formats will continue to polarize, as larger formats are favored for higher efficiency and small formats for more convenient shopping. Growing importance will be placed on efficiency improvements through chaining and streamlining activities. The power position will continue to shift from suppliers towards retailers. Increased efficiency and differentiation offers the consumers more choices and a lower price level.

The market development will depend mainly on three factors[39]. First, how well Lidl will succeed in Finland as discussed in section 6.1.1. Second, how and to what degree the competitors will respond to Lidl's entry, which will be discussed in the next segment. Third, whether there will be further market entries. Increased foreign competition would further accelerate the industry development and could potentially lead to a fierce price competition.

6.1.3. Impacts on incumbents

Due to Lidl's different positioning, the entry will not jeopardize the existence of incumbents, but erode their market shares. In order to fight for the decreasing market shares, the established competitors should not engage into a furious price war. This would cannibalize the industry profits, and the competitors would still not be able to match the price image of Lidl. Instead, the companies should improve their value proposition by increasing their differentiation and decreasing costs. Private label development is central both for differentiation and cost reduction. Main cost savings can be derived from developing international alliances and improving value chain efficiency. *The success factors of future retailing seem to increasingly emphasize network management*, as horizontal synergies are sought through international and domestic alliances, cooperation with suppliers becomes more central for developing private label products as well as improving value chain efficiency, increasing chaining provides multiple benefits, and partnerships might be leveraged for capitalizing on growth opportunities.

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[39] A fourth factor could be government actions, but as discussed earlier, but the government will likely not take protective measures in Finland.

The success of competitors in the intensifying competition will be determined not only by the current positioning and competitive strengths of the companies, but also by their willingness to develop their operations and increase cooperation both domestically and internationally early on. Lidl's market entry will probably impact the large format stores the most at first, as they are in a more direct competition with Lidl. Depending on how strongly those stores respond, the smaller store formats, which are potentially not as well positioned to improve their efficiency and value proposition, might end up suffering the most. Small grocery stores (<100m^2) complement Lidl's offering and might even have opportunities to improve their market position.

6.2. Reflections on theoretical framework

I have used this case to assess how applicable the theoretical components are, and I will discuss this in the following. Furthermore, in order to complement the limited research on the topic of foreign market entry's effects on industry, I will suggest some generalizations that could be drawn from the empirical study.

6.2.1. Applicability of theoretical components

There are several retail evolution theories (see section 2.5.1.), and the theories seem to provide valuable insights on certain aspects of this study, but have their shortcomings as well. I will discuss some of these theories individually and collectively in light of the empirical evidence. The research concerning how a foreign entrant affects industry development was mainly found in the banking sector. I will evaluate how well these results apply for this particular case and whether the results can be generalized.

6.2.1.1. Retail evolution theories

The case seems to support most of the theories explaining the development of retail industry. *Wheel of retailing* theory provides an explanation why there is an unexploited market niche that will allow Lidl to enter the Finnish market fairly easily. The theory would suggest that after establishing its position in Finland, also Lidl would trade up in order to increase its margins. However, as Lidl's competitive advantage and its fast international expansion is based on a low-cost, low-price business model, it is highly unlikely that this will happen. Lidl has traded up only in countries such as Spain, but not in order to gain higher margins, but because the local customers have not adopted its low-end business model.

Smaller retailers such as convenience stores might improve their market positions as they complement each other Lidl's offering by providing fill in purchases suggesting that *polarization principle* holds.

Multi polarization model provides a somewhat more comprehensive picture of the potential defensive strategies, not limiting examination to the store size dimension. The model suggests that Lidl's entry with its no-frills concept will facilitate counterbalancing actions in all dimensions: price, assortment, or size. This would explain defensive strategies of adjusting position away from new strategic group (see section 2.6.2.). However, the model fails to provide an insight on why the predominant defensive strategy seems to be, on contrary, adjusting position towards the new strategic group.

Retail life-cycle theory explains how Lidl can exploit its experiences in countries where discounting is in a more mature stage than in Finland in order to gain growth and a competitive advantage compared to the Finnish incumbents. The growth stage of discounting provides an incentive for further market entries into the discounting sector either by Finnish incumbents or foreign rivals.

Cycle of retail concentration provides a partial explanation why large retailers such as Lidl are able to gain market share and also why smaller competitors might be ill positioned to counter the competition as well as why the incumbents will need to develop purchasing alliances to improve their competitiveness. However, the model takes a one sided view on the sources of scale economies and needs to be complemented with other factors besides negotiation power leading to scale economies.

To conclude, in spite of their shortcomings, retail evolution theories seem to provide a good framework for assessing the motives of Lidl's entry. In understanding these motives, wheel of retailing is the key theory explaining the structural reasons. Retail life-cycle and cycle of concentration theories provide an insight on how Lidl can exploit its competitive advantages. However, the theories are of limited use for examining the indirect impacts of the entry. Wheel of retailing and retail life-cycle theories suggest that the incumbents could react by entering into the hard discounting segment. Polarization principle, multi polarization model, amd cycle of retail concentration model provide limited explanations for competitor defensive reactions. The theories do not provide a sufficient understanding of how the competitors could react to the market entry and how these reactions would in turn affect the industry evolution, and models such as the one for assessing strategic group defensive strategies (see figure 9) can complement the previous academic research.

6.2.1.2. Foreign entrants affecting industry evolution

The results of the studies about how foreign entrants affect industry development in banking sector (see section 2.5.2.) seem to mostly apply for this case as well. Lidl's market entry will affect the competition and thus motivate the Finnish retailers to increase their efficiency. Lidl will offer incumbents learning opportunities, allowing the competitors to copy its retailing techniques in hard discounting, private label strategies, and value chain efficiency. Lidl's market entry seems to have positive welfare implications for the customers, as it likely reduces the price level and increases the variety in retailing. I would suggest that the theory could hold also for other industries, as evidence is tested through replication in both banking and daily consumer goods retail industries (Yin 1994: 36).

I would suggest that the market entry of Lidl might induce further market entries into Finland not only because Lidl would test unknown market characteristics[40] and profitability as Seabright suggests (1996: 546-548), but also for two further reasons. First, as discussed in section 4.1.6.2., the established competitors might need to leverage foreign competitors in building their defensive strategies, i.e., if they decide to develop their discounter formats. Second, the foreign retailers considering their entry into the Finnish market need to speed up the implementation of their strategies before Lidl has increased the barriers to entry by building a solid position in the market. Naturally, if the foreign competitors find that Lidl's market entry will raise the entry barriers sufficiently as some of the interviewees found the market entry can discourage other retailers from entering.

6.2.2. Lidl's market entry facilitating industry convergence

Lidl's market entry will fortify the trends of Finnish retail industry converging with west European industry in a number of areas, such as increasing internationalization and retail format evolution. The market entry's effects on the convergence can be assessed using McGoldrick's

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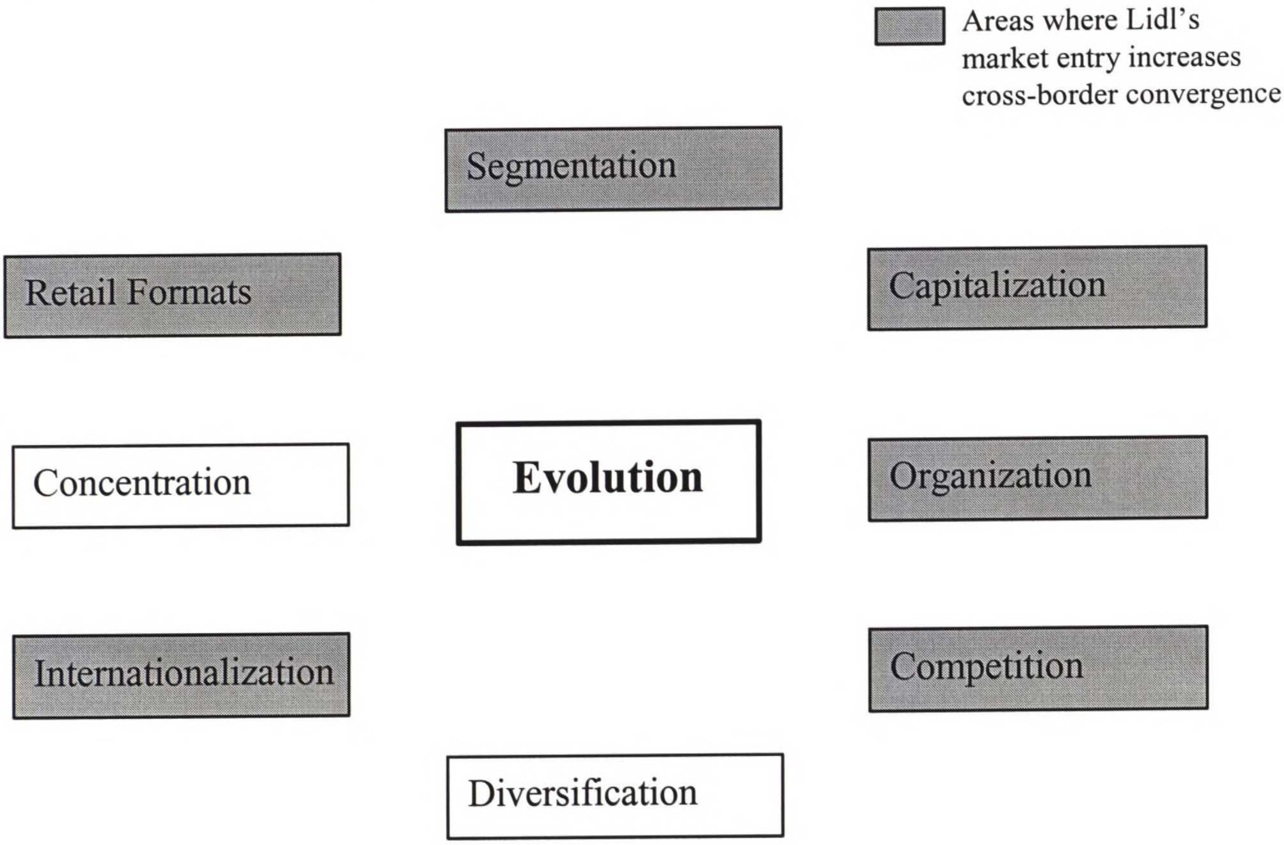
[40] These market characteristics were market elasticity of demand in Seabright's research and as I suggested in section 2.5.2,. it would here be consumer adoption of a hard discounting business model.

framework presented in section 2.5.3. Shadings in figure 16 show the areas where Lidl's market entry will increase the convergence between European and Finnish markets. We can see that Lidl will impact 6 out of the 8 areas, thus making it justified to claim that Lidl's market entry will increase the convergence.

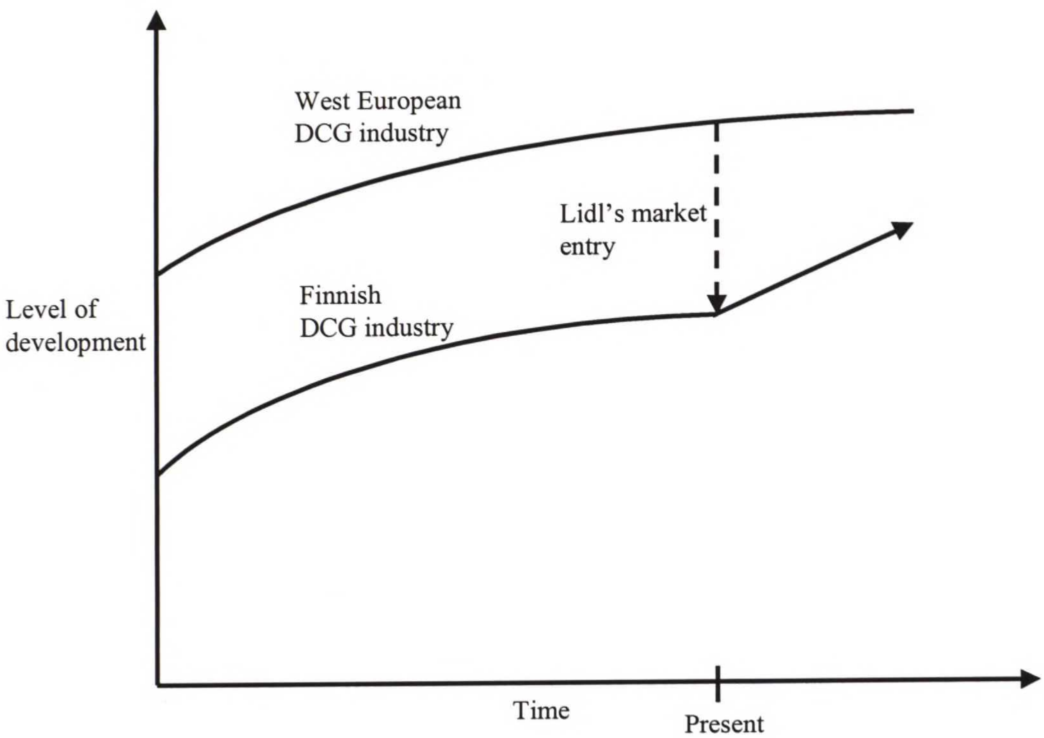
Figure 16. Industry convergence facilitated by Lidl



6.2.3. Foreign entrant driving industry evolution

In figure 17, have illustrated the development of west European and Finnish DCG industries. Even though European industry development is depicted on a higher development curve, it is only for illustrative purposes. I am not making statements whether the Finnish industry development lags behind European. There has been a continuous evolution in the Finnish industry, but now the evolution will be accelerated by a foreign entry. Lidl's market entry from a different development curve with certain market characteristics[41] more developed than in Finland will drive the development of the Finnish market in these dimensions as discussed throughout the report. As discussed in section 6.2.2., this will increase the convergence between Finnish and west European markets and reduce the gap between the two development curves, thus homogenizing the markets. We could imagine a third curve in the figure presenting the development of the DCG retailing in the Baltic States. Analogically to Lidl's market entry, the market entries of Finnish and west European retailers in the Baltic markets drive the industry development towards more convergent markets.

Figure 17. Foreign entrant driving industry evolution and industry convergence



I would suggest that the strength and nature of the impact the foreign entrant has on industry evolution is dependent on the entrant's relative competitive advantage. This would explain the differences observed in the market entries of different companies in the Finnish retail sector.

[41] The evaluations of level of development differ. Some market characteristics in Finland are less developed. Such characteristics include hard discount sector, private label penetration, retailer private label strategies, and CRM. (Interviews).

Sustainability of the competitive advantage is not necessarily an issue from an industry evolution point of view. Sustainability only determines whether the changes occur directly or indirectly. As in Lidl's case, most of the changes occur indirectly as the competitors seek to narrow down Lidl's competitive advantage. In fact, if the entrant's business model can easily be copied, this could even accelerate the evolution. However, from a competitor analysis point of view, sustainability of the competitive advantage is a key issue.

I would also suggest that this phenomenon could be generalized also to other markets and industries. Large international companies operating in mature, highly competitive markets enter new markets in order to exploit certain market characteristics that are not as developed in the target market as are in their market of origin in order to seek growth and higher profit margins and to increase their scale economies. By introducing new business models, the entrants drive the industry development through direct and indirect impacts and homogenize markets across borders. Benchmarking effects of Lidl's market entry in other European countries suggests that individual market characteristics and the relative competitive advantages will determine how big of an effect a foreign entrant has on an industry.

6.3. Opportunities for further research

As mentioned in section 3.1.1., this study can act as a preceding research in four areas.

1) The realized effects of Lidl's market entry on Finnish DCG industry could be analyzed ex-post. This research could be conducted both qualitative and quantitative. It is possible to carry out such research only after sufficient time has passed from the market entry, and data is available for several years subsequent to the market entry. However, impacts on some areas are observable in a considerably shorter time. Such research would provide an interesting point of comparison for the hypotheses of this study and thus the validity of my approach.

2) A cross-industry analysis of the impacts of foreign retailer market entries on Finnish industries could be another area for further research. The trend of foreign entries has undoubtedly impacted many industries, but the research in this area is lagging behind. My hypothesis is, that there are several similarities in these impacts as suggested throughout this paper. Identifying these similarities could be utilized when building scenarios about impacts of a foreign entrant on

another industry. Analyzing the differences and their underlying reasons would provide valuable insights for entrant and incumbent decision making.

3) A cross-market comparison of the impacts of Lidl's (or some other company's) market entry on industries in different countries could be carried out. This could reveal structural and dynamic factors that affect the impacts. A model could be constructed to describe the impacts as a function of these factors. This model could be used by the competitors to prepare for a market entry and by the entrant to evaluate the attractiveness of the market entry. Such analysis has been used in this research on a high level as one of the methods for scenario building.

4) A complementing approach for my industry level approach would be examining reactions of individual competitors ex-post, analyzing the success of and the underlying reasons for the reactions. In this study, I have suggested potential reactions and some elements that potentially affect group and chain level success. My hypothesis would be, that large groups have the best potential to respond with efficiency improvements. Spar, considering their moderate market position with regards to its ambitious market share plans, seems highly likely to seek structural solutions. Wihuri might be interested in focusing on some of the more profitable industry segments. International ownership arrangements concerning, e.g., Ruokakesko could have a significant impact on the industry development.

For all of the above research areas, this study provides a framework as I have identified the potential areas where the market entry could affect and the main factors influencing the impact. I have also built hypotheses about what the nature of impact could be and what determines the strength of the impact.

6.4. End words

It will be interesting to observe, what the actual changes caused by Lidl's market entry will be. In this report, I have identified the potential areas of change and some of the underlying factors affecting the impact, but the magnitude of change is dependent on multiple factors. These factors derive mostly from demand side and strategic decision making of the competitors that can only be speculated beforehand. One observation during the research has been that the views of different stakeholders vary considerably, mostly reflecting personal motives, and should be regarded with caution. One thing is for sure, Lidl will enliven the development of retail sector in

Finland, and some changes are bound to occur. The only certain estimate on the nature of these effects is, as one interviewee phrased it: “Time will tell”.

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APPENDICES

1. Retail companies operating in Finland

Name	Owner	Company type	Other fields of business	Daily consumer goods retail sales, MEUR
K-ryhmä	Kesko Oyj	Plc, HEX	Kesko: hardware, builders supplies, agriculture, machinery, home and specialty goods, car import and marketing, trading house operations	3702
S-ryhmä	Customer owners	Cooperative soci	Specialty goods, department stores, hotels, restaurants, hardware, agriculture, automobiles, service stations	2851
Tradeka+Elanto	Tradeka Group Oy/ E	Cooperative soci	Hotels, restaurants	1222
Spar-ryhmä	Axfood AB	Plc, HEX I-List	N/A	901
Wihuri	Familyowned	Ltd	Packaging, technical trade, specialty products and services	648
Rautakirja	SanomaWSOY	Plc, HEX	Magazine sales, book sales, movie theaters, restaurants, Internet	257
Stockmann Oyj	Publicly listed	Plc, HEX	Department stores, cars, mail order and e-commerce, clothing	119
Other	N/A	N/A	N/A	155

Name	Market share, Percentage	Number of outlets in Finland	Main chains	Wholesaler	Purchasing alliance
K-ryhmä	37,6	1249	KKKK-Citymarket, KKK-Supermarket, KK-Market, K-Lähikauppa, Rimi, Pikkolo/ K-Extra	Ruokakesko Oy	Associated Marketing Services
S-ryhmä	28,9	576	Prisma, S-Market, Alepa/ Sale, Sokos	Inex Partners Oy	Inter Coop/ NAF internat
Tradeka+Elanto	12,4	568	Euromarket/Maximarket, Valintatalo, Siwa	Inex Partners Oy	Inter Coop/ NAF internat
Spar-ryhmä	9,1	304	Eurospar, SuperSpar, SparMarket, Rabatti, Spar Express	Tuko Logistics Oy	Buying Internat Group Spar
Wihuri	6,6	140	Eurospar, Sesto Etujätti, Sesto, Hansa, Tarmo, Ruokavarasto	Tuko Logistics Oy	N/A
Rautakirja	2,6	721	R-Kioski		N/A
Stockmann Oyj	1,2	6	Stockmann	Tuko Logistics Oy	N/A
Other	1,6	N/A	N/A	N/A	N/A

Sources: Annual reports; Company websites; A.C. Nielsen Finland ref. Finnish Food Marketing Association 2001; McGoldrick & Davies 1995: 136-137; LP International/ IGD Research ref. Verdict 2001: 3.

2. Wholesale companies operating in Finland

Name	Owner	Company type	Other fields of business	Daily consumer goods wholesales, mEUR	Customers
Ruokakesko Oy	Kesko Oyj	Ltd.	HoReCa wholesale	1476	K-ryhmä
Inex Partners Oy	SOK, Tradeka	Ltd.	Specialty goods, coffee, spices	1333	S-ryhmä, Tradeka/Elanto
Tuko Logistics Oy	Wihuri Oy, Suomen Spar Oyj (35%), Stockmann Oyj, Heinon Tukku Oy	Ltd.	N/A	676	Wihuri Oy, Suomen Spar Oyj, Stockmann Oyj, Heinon Tukku Oy
Heinon Tukku Oy	Familyowned	Ltd.	HoReCa wholesale, office supplies	N/A	N/A

Sources: A.C. Nielsen Finland ref. Finnish Food Marketing Associating 2000; Company websites.

3. Retail outlet classifications

The most common classification of retail outlets is by size. The classification has legislative effects, e.g., the opening hours of the outlets are defined by law for each outlet category. The classification follows the one presented by Finnish Food Marketing Association (2001). Other categorizations can be done by, e.g., mode of operating and location.

Department store (tavaratalo) is a retail outlet selling products from multiple areas, none of which exceeds 50 per cent of the sales area. The sales area of the store must be over 2500 m^2. The level of service is usually high in department stores.

Hypermarket is a retail outlet selling products from multiple areas. The sales surface of groceries do not surpass 50 per cent of the total sales, but most of the sales come from daily consumer goods sales. The sales area of the store is at least 2500 m^2. Hypermarket is mainly operated by self-service concept.

Supermarket means a daily consumer goods outlet, which has a sales area over 400 m^2, over half of which is allocated to grocery sales. Supermarket is mainly operated by self-service concept. Supermarkets are commonly divided into large (over 1000 m^2) and small (400 -1000 m^2).

Self-service store (valintamyymälä) is large self-service store if it has a square area of 200 -399 m^2 and small if square area is 100 -199 m^2.

Small store (pienmyymälä) and *kiosk* (kioski) are daily consumer goods outlets with a sales square area under 100 m^2.

4. Interview questions

BACKGROUND

- What is your position in the company and what are your primary areas of responsibility?
- What is your experience in the daily consumer goods industry?
- How have you gained information about Lidl?

INDUSTRY LEVEL QUESTIONS

- What are your estimates of annual growth rates in the industry for the next 3-5 years? What drives this growth?
- How will Lidl's entry affect the market growth?
- How competitive is the Finnish industry compared with west European?
- In what ways is the Finnish industry behind/ ahead of the west European industry development?

- What is the maximum market share that hard discounters can gain in Finland in ten years?
- Do you believe the market entry will attract other discounters?
- Do you find that Aldi might follow Lidl into Finland?
- Do you believe that incumbents might engage into hard discounting?
- What are the main mobility barriers for incumbents moving into hard discounting sector?
- Do the incumbents need foreign partnerships to successfully develop their hard discounting formats?
- What advantages and disadvantages would the incumbents possess in hard discounting?

- What effects does the increasing industry capacity have?
- Do you believe there will be structural changes in the industry due to intensified competition?
- Who/ what kind of stores will lose the most? Who has the best opportunities to counter the threat?

COMPANY LEVEL QUESTIONS

- How big of a market share do you believe Lidl will gain in Finland in three years?
- What are Lidl's biggest obstacles in gaining it?
- How many stores will Lidl realistically be able to construct within the next three years?
- What institutions control the planning permit approvals in Finland? What is their attitude towards Lidl?
- Do you believe that Lidl will have problems in gaining planning approvals for its stores?
- How long will it take for Lidl to breakeven?

- What are the incumbents' main defensive strategies against Lidl?
- What factors determine the group/ chain level abilities to defend their position against Lidl?
- Which store formats are best positioned to compete with Lidl?
- Which store formats will lose the most as a consequence of Lidl's entry?
- What are the key components of differentiation in DCG retailing in chain and group level?
- Will Lidl's market entry affect the marketing of the incumbents and how?

- What share of DCG sales would you estimate private label products to have in Finland?
- How will Lidl's entry affect the PL strategies of Finnish incumbents and the penetration?
- Do you see PLs as an important element in differentiation?
- How much larger margins do PLs provide?
- How will increasing this PL development affect the position of suppliers?

- Will the Finnish consumers adopt Lidl's business model? What are the main obstacles for Lidl to sell its concepts to the customers?
- How price sensitive the Finish customers are? How large discounts will Lidl need to offer in order to persuade the customers to switch?
- What are the main elements in building customer loyalty?
- How will Lidl's entry change the loyalty schemes of established companies?
- Do the incumbents have opportunities to further develop their customer loyalty schemes?
- Do you see providing savings bank services as a future tool for building customer loyalty?

COSTS

- How much lower prices can Lidl offer?
- How will Lidl's market entry affect the industry price level? How fast is the impact?
- Is it possible for Lidl to deploy nationwide pricing or are there competitive restrictions? Will Lidl increase the local price differences?
- Should the retailers respond by reducing their prices at the expense of profitability?

- What are the main components in retailer cost breakdown?
- What are the revenue structures of Lidl and incumbents aggregated on industry level like (see appendix 7)?
- Where do the differences in each component derive from?
- How much and in which cost components can incumbents reduce their costs? Will this be adequate for persuading the customers to choose incumbent stores?

- How big of a share of DCG products are imported in Finland?
- How large and what benefits do incumbents gain from international purchasing alliances?
- What are the opportunities for incumbents to further improve their negotiation power through alliances?
- Does competitive legislation allow for forming domestic purchasing alliances?

- How efficient are incumbents in logistics compared to west European retailers? What are the main areas of improvement?
- In addition to purchasing, what could be potential areas for horizontal cooperation for Finnish retailers?
- Could savings be derived from sharing logistics network?
- What is the level of ECR and CM development in Finland? Are there opportunities for further efficiency increases in this area?
- What are the main factors hindering the ECR/ CM development?
- How do you consider the level of chaining in the Finnish DCG retail?
- Are there further opportunities for efficiency increases through chaining?
- In what further areas can the incumbents increase their efficiency?

5. Summary of interviewee answers

	Interviewee 1	Interviewee 2	Interviewee 3	Interviewee 4	Interviewee 5
Lidl's market share in 3 years.	3-5%.	5%.	2-3%.	3%, potentially larger in durable goods.	3-5%.
Main issues for Lidl in reaching this market share.	How customers will adopt the business model.	No frills, price based concept.	Providing adequate quality while competing on prices.	Finding outlet locations, potentially two-stop shopping.	Lack of familiar products.
Number of outlets in 3 years.	100.	~100.	N/A.	N/A.	Market share estimate based on 100 outlets.
Hard discounting market potential in Finland in 10 years.	Clearly under 10%.	10% at maximum.	Clear niche exists.	10-15%.	5% is by no means the upper limit.
Main defensive strategies for incumbents.	Finding strengths, e.g., brands and know-how, and strengthening them.	Current concepts that are differentiated from Lidl.	Emphasizing brands and fighting against "cheap trend", e.g., with services.	Private label development, price strategy, overall customership, cost cutting.	Adjusting positions towards Lidl.
Most vulnerable store formats.	Stores that are located in Lidl's vicinity and hypermarkets.	Hypermarkets positioned for price.	N/A.	Smaller formats.	Smaller forrmats operating in vicinity of Lidl and potentially box stores.
Factors determining who will lose the most.	Customer loyalty, chaining, solidness of concepts.	Price sensitivity of customer segments.	Current market position.	Mid-sized groups that are currently performing weakly will have increasing difficulties.	N/A.
Impacts on private label development.	Increasing penetration, both standard and hard discounting lines.	Increasing penetration, hard discounting lines "as little as possible, but adequately".	Penetration might increase.	Increasing penetration, hard discounting lines.	Increasing penetration, hard discounting lines, no large group level differences.
Price (image) difference between Lidl and incumbent average.	15%.	10%.	~10%.	10%.	30-40% lower prices in certain product ranges at first.
Main areas for cost reduction.	Supply chjain management, logistics, purchasing.	No need for cost cutting.	Logistics, purchasing, potentially personnel.	Purchasing, vertical value chain efficiency.	N/A.

6. Lidl's international operations

6.1. Lidl's operations by country

Country	Year of entry	Number of outlets (year)	Market share, Percentage (year)	Sales, MEUR (year)
Austria	1998	53 (1999)	~4 (1998)	70 (1999)
Belgium	1995	118 (2000)	2 (2000)	N/A
Czech	1998	34 Kaufland outlets (2002)	11 (1999)	N/A
France	1989	951 (2001)	1.5 (1999)	1500 (1999)
Germany	N/A	ca. 2000 (2002)	9 (2000)	12300 (2000)
Greece	1999	40 (2001)	N/A	120-170 (2001e)
Ireland	2000	27 (2002)	1-2 (2001)	N/A
Italy	1992	230 (2001)	0.7-0.8 (1998)	530 MECU (1997)
Netherlands	1997	337 (2001)	1 (2001)	N/A
Portugal	1996	71 (1999)	N/A	N/A
Spain	1994	280 (2001)	1 (1999)	550 (1999)
U.K. (England, Scotland, Wales)	1994	N/A	1.2 (2000)	1550 (2000)

NOTE: Accuracy of figures is subject to questioning, as contradictory estimates were found regarding some figures, and no data was available for crosschecking many of the figures, and single data points have thus been relied on.

Sources: E.g., Reuters; Kolkman 2000.

6.2. Selected market characteristics

Country	PL penetration (by value), 1997, Percentage	PL discount, 1997	Level of industry concentration
Austria	30	15	N/A
Belgium	22	15	Medium
Czech	N/A	N/A	Low
France	23	25	Medium
Germany	21	25	Low
Greece	7	20	N/A
Ireland	12	15	N/A
Italy	11	20	Low
Netherlands	21	15	High
Portugal	10	15	N/A
U.K. (England, Scotland, Wales)	40	10	Medium
Spain	10	15	Low

Sources: E.g., Reuters; Ehrnreich & Ackrill 1998; Ehrnreich 1998.

7. Definition of revenue breakdown components

Product costs — Costs of product for the retailer including purchasing price and logistics costs.

Personnel costs — Direct and indirect personnel costs.

Real estate costs — Including rent and amortization of building lot, real estate, and equipment.

Overhead costs — Including, e.g., information systems and head office and support functions. Excluding marketing costs.

Marketing cost — Marketing costs, including costs for loyalty schemes.

EBIT — Earnings before interest and taxes.